BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 01-92
Developing a Unified Intercarrier	)	
Compensation Regime	)	

REPLY COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

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EXECUTIVE SUMMARY

A possible reaction to the multitude of comments and positions on these very important intercarrier compensation ("ICC") issues would be to throw up one's hands and conclude that this proceeding is going to result in nothing but paralysis. The positions and arguments of the commenters are so diverse, and in many instances directly oppositional, that it should be obvious that there is nothing remotely close to consensus on anything other than the conclusion that there is a problem with ICC.

In this regard, it is ironic that the so-called Intercarrier Compensation Forum ("ICF"), whose proposal requires the largest changes in ICC and existing industry structure, says that adopting anyone else's position would be contentious and lead to litigation.[1] Given the **$9.6 billion** in current ICC revenues, it is crystal clear that

[1] ICF Comments, p. 67.

adopting any party's position, or achieving a compromise between positions, or devising an entirely new solution will by its very nature be contentious and lead to litigation.[2]

That being said, the proposal submitted by the National Association of State Utility Consumer Advocates ("NASUCA") is the most evolutionary of the proposals, and the most respectful of state jurisdiction. Except for changes to the USF to rationalize local switching support and to create inducements for states to reduce their intrastate access charges, the NASUCA proposal retains existing structures, continues past progress on ICC, and directly addresses the problems of rate disparity that gave rise to this proceeding in the first place. As a result, there is no question concerning the Commission's authority to adopt and implement NASUCA's plan. NASUCA's proposal also maximizes the Commission's flexibility to meet changing conditions since it is an interim plan, and not a purported permanent solution, as most of the other proposals claim to be. The NASUCA plan does not irrevocably commit the Commission to one course of action or the other. However, adoption of the NASUCA plan would reduce disparities in ICC rates, would result in ICC becoming a proportionately smaller issue,[3] and would set the stage for transition to capacity-based ICC charges if deemed appropriate at the end of the five-year ICC rate phase-down.

[2] This, indeed, is the fate of most of the decisions of Federal Communications Commission ("Commission").

[3] At the end of the five-year phase-down under the NASUCA plan, ICC revenues would amount to approximately $4.7 billion compared to $9.6 billion in 2003. As a result, ICC revenues would drop from 4% of total telecommunications revenues to 2% of total revenues. See NASUCA Comments, pp. 12-14.

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I. INTRODUCTION

The National Association of State Utility Consumer Advocates ("NASUCA")[4] hereby responds to comments concerning the Federal Communications Commission's ("FCC" or "Commission") Further Notice of Proposed Rulemaking ("FNPRM") on various proposals to move to a unified system of intercarrier compensation ("ICC").[5] NASUCA previously submitted its proposal for reform of ICC to the Commission, and the proposal was included as part of the FNPRM.[6]

The initial comments show the extreme diversity of views on the subject of ICC, accompanied by a lack of substantial support for any one of the proposals previously

[4] As set forth on page 1 of NASUCA's Initial Comments, NASUCA is a voluntary association of 43 advocate offices in 40 states and the District of Columbia, incorporated in Florida as a non-profit corporation.

[5] As with NASUCA's initial comments, numerous representatives of various NASUCA member offices contributed to these reply comments. NASUCA's project leader was Billy Jack Gregg, Director of the West Virginia Consumer Advocate Division.

[6] FNPRM, ¶56.

submitted to the Commission.[7] NASUCA continues to believe that its proposal substantially addresses the problems identified in the FNPRM without radical changes to the current system and within the confines of settled law. The Commission should be aware that the National Association of Regulatory Utility Commissioners ("NARUC"), in its comments, stated that "*of the proposals listed in the FNPRM*, NASUCA's plan … comes closest to the listed NARUC principles…."[8]

There were a myriad of issues posed by the FNPRM, and the diversity of the comments further expands that universe of issues. There are, however, three key issue areas on which these reply comments focus.

The first issue -- principally presented by the proposal and comments of the so-called Intercarrier Compensation Forum ("ICF") -- is whether the Commission should move to a mandatory system where each carrier recovers virtually all of its costs from its own customers -- and almost none from the other carriers who use the first carrier's network. ICF's mandatory "bill-and-keep" proposal is opposed by members of almost all segments of the industry. As shown in their comments, a mandatory bill-and-keep regime ignores basic principles of cost causation and would create opportunities for arbitrage that are just as problematic as those under the current fragmented regime.

Second, a key element of the ICF proposal -- and of certain other proposals -- is federal abrogation of intrastate ICC mechanisms. The weight of the comments shows that such preemption is neither lawful nor wise.

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[7] The extensive level of disagreement among commenters confirms the error in the Commission's suggestion that it might be better to adopt one of the industry proposals as a unified whole. FNPRM, ¶ 62.

[8] NARUC Comments, p. 4 (emphasis in original).

Third, the ICF and many of the other industry proposals contain a fundamental guarantee of replacement of revenues that are lost as a result of restructuring ICC.[9] The principal mechanism of the revenue guarantee is recourse to increased non-bypassable end-user charges such as the subscriber line charge ("SLC"); the remainder of the recovery comes through the federal universal service fund ("USF"). Those who propose such revenue guarantees never adequately explain why a guarantee is necessary, appropriate, or lawful. Using the SLC and the USF for such a guarantee violates the fundamental purposes of both mechanisms.

NASUCA agrees that the current regime of intercarrier compensation cannot be sustained in the long run. NASUCA also believes that the Commission must not give in to the temptation to do nothing; the Commission must continue to move forward with ICC reform. As set forth in the initial comments and herein, NASUCA believes that its proposal provides the best vehicle for continued progress. NASUCA's plan will establish lower target ICC rates over an interim five-year period, will minimize the disparity among ICC rates, will respect state authority over intrastate rates, and will minimize the impact on local rates and the federal universal service fund. Most importantly, NASUCA's plan builds on past Commission decisions on ICC and falls squarely within the existing legal authority of the Commission. NASUCA urges the Commission to implement the NASUCA ICC reform plan with all deliberate speed.

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[9] Indeed, as NASUCA's comments showed, some plans guarantee replacement of all current ICC revenues, not the actual ICC revenues at the time of the changes to ICC rates. See NASUCA Comments, pp. 28-34.

II. IDENTIFICATION OF, SUPPORT FOR, AND OPPOSITION TO THE PROPOSALS

A key sign of the diversity of positions on ICC issues is that the ICC reform proposals continue to change, and the coalitions that support these proposals continue to change as well. There were seven groups identified in the FNPRM as submitting proposals: ICF;[10] the Expanded Portland Group ("EPG");[11] the Alliance for Rational Intercarrier Compensation ("ARIC");[12] the Cost-Based Intercarrier Compensation ("CBICC");[13] Home Telephone and PBT Telecom ("Home/PBT");[14] Western Wireless;[15] and NASUCA.[16] Based on the comments filed, EPG and ARIC have combined into the "Rural Alliance";[17] CBICC has no official group comments;[18] and Home/PBT did not file comments beyond their previous *Ex Parte*. ICF, Western Wireless and NASUCA filed comments expanding upon their proposals.

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[10] FNPRM, ¶¶ 40-44.

[11] *Id.*, ¶¶ 45-47.

[12] *Id.*, ¶¶ 48-50.

[13] *Id.*, ¶ 51.

[14] *Id.*, ¶ 52-53.

[15] *Id.*, ¶ 54-55.

[16] *Id.*, ¶ 56

[17] Rural Alliance Comments, p. 1.

[18] Comments supporting the CBICC proposal were filed by Pac-West Telecomm, Inc., US LEC Corp., RCN Telecom Services, Inc., Cavalier Telephone Co., PAETEC Communications, Inc., Broadview Networks, Inc., Bridgecom International, Inc., and Telcove Operations, Inc. ("Pac-West") and by KMC Telecom, Inc. and Xpedius Communications, Inc. ("KMC"). Ionary Consulting ("Ionary"), although endorsing the NARUC principles, finds the CBICC proposal to be the best of the lot.

The FNPRM noted that NARUC and CTIA - The Wireless Association ("CTIA") had filed statements of "principles."[19] NARUC's comments focus -- understandably -- on the issue of preemption of intrastate authority.[20] The NARUC Task Force on Intercarrier Compensation ("NTFIC") also submitted a proposal,[21] although NARUC's comments point out that "NARUC has not yet fully endorsed it."[22] CTIA has expanded on its principles and submitted a "proposal" as part of its comments.[23]

The vast majority of the comments do not endorse any one of the proposals.[24] In this regard, the attempt of the United States Telecom Association ("USTA") to find consensus among the proposals[25] is unavailing. No such consensus exists.

The comments also show that positions are diverse among industry segments. For example, although ICF consists of large carriers -- such as AT&T Corp. ("AT&T"), MCI, Inc. ("MCI"), SBC Communications Inc. ("SBC"), and Sprint Corporation ("Sprint") -- and smaller companies -- like competitive local exchange carriers ("CLECs") Global Crossing North America Inc., Level 3 Communications LLC and General Communications, Inc. -- and rural incumbent local exchange carriers ("ILECs") -– such

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[19] FNPRM, ¶¶ 57-59. The FNPRM describes NASUCA's position as "principles" (*id*., ¶ 58), but NASUCA's *Ex Parte* filing included specific action details.

[20] See NARUC Comments, pp. 4-14.

[21] See NARUC *Ex Parte* (May 18, 2005), submitting "Version 7" of the NTFIC proposal.

[22] See NARUC Comments, p. 2, n. 3.

[23] CTIA Comments, p. ii.

[24] Certain of the comments address specific issues not really germane to the core issues in the FNPRM. That includes comments by ASAP Paging Inc. ("ASAP") and F. Cary Fitch d/b/a Fitch Affordable Telecom ("Fitch"), whose concerns are mostly focused on WC Docket 04-6. The Information Technology Association of America's ("ITAA") sole contribution is to oppose the imposition of ICC on Internet service providers ("ISPs").

[25] See USTA Comments, pp. 19-23.

as Iowa Telecom and Valor Telecommunications, LLC -- other members of these same industry segments do not support, and some oppose, the ICF proposal.

For example, SBC's fellow regional Bell Operating Companies ("RBOCs") BellSouth Corporation ("BellSouth") and Qwest Communications International Inc. ("Qwest") each have their own plans, and Verizon opposes fundamental aspects of the ICF proposal. Also on the ILEC side, Cincinnati Bell Inc. ("CBI")[26] does not support ICF or any of the other proposals. The Coalition for Capacity-Based Access Pricing ("CCBAP"), a group of ILECs supporting the policy indicated by the group's name, adamantly opposes bill-and-keep. Likewise, the Centralized Equal Access Providers ("CEAP")[27] show how bill-and-keep will undermine their Commission-approved statewide networks. SureWest Communications ("SureWest") says that "[t]he record does not support any of the plans in the current form at this time."[28]

Many CLECs do not support the ICF proposal, either.[29] On the fundamental ICF issue of bill-and-keep, National Cable & Telecommunications Association ("NTCA") and Time Warner Inc. ("TWI") support a bill-and-keep regime (even though they do not explicitly support ICF),[30] while CLECs Time Warner Telecom, Conversent

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[26] CBI's ILEC subsidiary, Cincinnati Bell Telephone ("CBT") is a "2% rural carrier" that is nonetheless anything but small and rural. CBT serves over 800,000 access lines in contiguous territory in Ohio, Indiana and Kentucky.

[27] CEAP is a coalition of Iowa Network Services, Onvoy, Inc. and South Dakota Network, LLC, who provide equal access facilities in Iowa, Minnesota and South Dakota, respectively.

[28] SureWest Comments. p. iii. Surewest reviewed only EPG, ARIC and ICF. *Id.*, p. 22.

[29] CCG Consulting, Inc. ("CCG"); CompTel/ALTS; Cox Communications, Inc. ("Cox"); Mpower Communications Corp. ("Mpower"); NuVox, Inc. ("NuVox"); PrairieWave Telecommunications, Inc. ("PrairieWave"); Rural Independent Competitive Alliance ("RICA").

[30] WilTel Communications, LLC ("WilTel") supports either bill-and-keep or a "nominal" unified rate. WilTel Comments, p. 14.

Communications Inc., Cbeyond Communications LLC and Lightship Telecom ("TWT") and XO Communications, Inc. ("XO") argue against mandatory bill-and-keep.[31]

On the rural ILEC side -- which most commenters acknowledge will take the largest hit from ICC changes[32] -- many of the small rural carriers and their cohorts support the Rural Alliance.[33] More do not.[34] Some rural ILECs have their own plans.[35] Comporium would like to pick and choose among the plans.[36] Most rural ILECs and their organizations, like Great Lakes Comnet ("Comnet"), identify the

> dangerous potential outcome [that] exists in the various proposals before the Commission, particularly those supported by the [RBOCs], to impose an industry network structure which would competitively favor the RBOCs and essentially force small and rural LECs to acquiesce to an RBOC network design.[37]

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[31] Mid America Computer Corporation ("MACC"), a "billing solutions company," opposes fundamental portions of the ICF proposal. Allied National Paging Association ("Allied") presents the views of paging companies.

[32] See, e.g., ICF, NASUCA, NECA and Rural Alliance.

[33] California Small LECs ("CaSLECs"); Colorado Telecommunications Association, Oregon Telecommunications Association and Washington Independent Telephone Association ("CTA"); Eastern Rural Telecom Association ("ERTA"); GVNW Consulting, Inc. ("GVNW"); Iowa Telecommunications Association ("ITA"); South Dakota Telecommunications Association ("SDTA"); Specified Members of the Wyoming Telecommunications Association ("Wyoming Independents"); TCA, Inc. - Telcom Consulting Associates ("TCA"); TDS Telecommunications Corporation ("TDS").

[34] Alexicon Telecommunications Consulting ("Alexicon"); Beehive Telephone Company, Inc. ("Beehive"); CenturyTel, Inc. ("CenturyTel"); Columbus Telephone Company ("CTC"); John Staurulakis, Inc. ("JSI"); ICORE Companies ("ICORE"); Independent Georgia Telephone Companies ("IGTC"); Interstate Telecom Consulting, Inc. ("ITCI"); Rural Iowa Independent Telephone Association ("RIITA"); Minnesota Independent Coalition ("MIC"); Montana Independent Telecommunications Systems, Montana Telecommunications Association and Mid-Rivers Telephone Cooperative ("MITS, et al."); National Telecommunications Cooperative Association ("NTCA"); North Dakota Association of Telecommunications Cooperatives ("NDATC"); South Slope Cooperative Telephone Company, Inc. ("South Slope"); Wisconsin State Telecommunications Association ("WisSTA").

[35] See Comments of Frontier Communications ("Frontier").

[36] Rock Hill Telephone Company d/b/a Comporium Communications, Lancaster Telephone Company d/b/a Comporium Communications and Fort Mill Telephone Company d/b/a Comporium Communications ("Comporium").

[37] Comnet Comments, p. 2. See also National Exchange Carrier Association ("NECA") Comments, p. 2.

Perhaps it would be possible to parse each entity's interests in order to determine why it supported or opposed one proposal or another, one part of a proposal or another, or supported none of the proposals. For example, NASUCA's opposition to the ICF and the Rural Alliance proposals stems mostly from those proposals' shifting of revenue recovery from charges on carriers to unavoidable charges on end users, through increased SLCs and increased USF assessments. On the other hand, VeriSign, Inc. ("VeriSign") supports bill-and-keep for their ISDN User Part ("ISUP") signaling traffic and for their IP-enabled next- generation network ("NGN") architectures. The diversity of positions among wireless carriers is so great that it would require further examination to determine underlying motives of each carrier.[38]

The comments of state regulatory commissions generally support the NARUC principles, but do not affirmatively support the NARUC NTFIC proposal.[39] The governments of two states -- Alaska and Hawaii -- show how ICC and related issues, such as rate integration, affect their isolated areas.[40]

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[38] As noted, CTIA has a proposal, supported by Dobson Cellular Systems, Inc. and American Cellular Corporation ("Dobson, et al"); T-Mobile USA, Inc. ("T-Mobile"); and United States Cellular Corporation ("USCC"). Western Wireless joined with SunCom Wireless, Inc under the name "Independent Wireless Carriers ("IWC") to submit a separate wireless proposal. Nextel Communications, Inc. ("Nextel"), Nextel Partners, Inc. ("Nextel Partners"), and the Rural Cellular Association ("RCA") support bill-and-keep. MetroPCS Communications, Inc. ("MetroPCS") is the wireless member of the ICF. Leap Wireless International, Inc. ("Leap"), Corr Wireless Communications, LLC ("Corr") and Verizon Wireless do not support any specific proposal.

[39] Indiana Utility Regulatory Commission ("InURC"); Iowa Utilities Board ("IUB"); Maine Public Utilities Commission and Vermont Public Service Board ("MePUC/VtPSB"); Montana Public Service Commission ("MtPSC"); National Association of Regulatory Utility Commissioners ("NARUC"); Nebraska Public Service Commission ("NebPSC"); New Jersey Board of Public Utilities ("NJBPU"); North Dakota Public Service Commission ("NDPSC"); Public Service Commission of the State of Missouri ("MoPSC"); Public Service Commission of Wisconsin ("WisPSC"); Public Utilities Commission of Ohio ("PUCOh"); Public Utility Commission of Oregon ("PUCOr"); Public Utilities Commission of Texas ("PUCTx"); Regulatory Commission of Alaska ("RCA"); South Dakota Public Utilities Commission ("SDPUC"); State of New York Department of Public Service ('NYDPS"); Wyoming Public Service Commission ("WyPSC").

[40] State of Alaska ("Alaska"); State of Hawaii ("Hawaii"). Both states oppose forbearance from or otherwise diminishing rate integration and geographic rate averaging for long distance calls.

Representatives of consumers uniformly reject the industry proposals. This includes NASUCA members,[41] NASUCA members working in combination with national consumer groups,[42] and other groups representing consumer interests.[43] As set forth below, proposals to radically restructure ICC by adopting mandatory bill-and-keep and reducing default ICC rates to zero must be rejected. The Commission should retain positive ICC rates, but reduce disparity among these rates by moving to target ICC rates over a five-year period.

III. MANDATORY BILL-AND-KEEP SHOULD NOT BE ADOPTED

A. Carriers That Use Networks of Other Carriers Should Pay for Such Use.

A wide variety of carriers, carrier organizations, regulators, and consumer groups agree with the basic principle that carriers using the networks of other carriers to originate, terminate or transit traffic should pay for the use of such networks.[44] These parties recognize that retaining positive ICC rates not only sends proper price signals, but

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[41] Indiana Office of Utility Consumer Counselor ("InOUCC"); the New Jersey Division of the Ratepayer Advocate ("NJRPA"); and the Wyoming Office of Consumer Advocate ("WyOCA"). WyOCA raises issues with the initial NASUCA filing that should be substantially reduced by the full NASUCA proposal contained in the initial comments.

[42] Texas Office of Public Utility Counsel, Consumer Federation of America and Consumers Union ("TxOPC").

[43] Ad Hoc Telecommunications Users Committee ("AHTUC"); Teletruth. Teletruth focuses its opposition on proposed increases to the SLC. The Office of Advocacy, U.S. Small Business Administration ("SBA") unfortunately limits its advocacy to carriers, rather than to the small businesses that are customers of carriers large and small.

[44] *Carriers*: BellSouth Comments, p. 5; ERTA Comments, pp. 3-5; Comnet Comments, pp. 4-5; KMC Comments, pp. 28-31; Pac-West Comments, pp. 20-28; Prairie Wave Comments, pp. 3-4; TDS Comments, pp. 16-18; Verizon Comments, p. 21. *Carrier Organizations and Consultants*: Alexicon Comments, p. 2; GVNW Comments, p. 5; ITA Comments, pp. 1-2; MITS Comments, pp. 12-13; NECA Comments, pp. 7, 11. *Regulators*: PUCOh Comments, p. 18; SDPSC Comments, pp. 9-10. *Consumer Groups*: NASUCA Comments, p. 4; TxOPC Comments, p. 6.

also prevents potential network arbitrage just as serious as that caused by the current regime of widely varying ICC rates. Retaining positive default rates for ICC is preferable for several reasons:

- Positive default rates recognize that the costs of interconnection are not *de minimis*;
- Positive default rates recognize that not all traffic between carriers is in balance;
- Positive default rates are consistent with long-run incremental network costs;
- Positive default rates minimize gaming of the ICC system; and
- Positive default rates maintain a "third revenue stream" to support the revenue requirements of carriers, and reduce pressure on local rates and universal service funding, especially for rural carriers.[45]

This is not to say that the disparity in existing ICC rates should not be reduced, or that carriers should not be encouraged to enter into voluntary bill-and-keep arrangements when traffic is more or less in balance and when it is in the interests of both parties. The Commission should balance the concerns over arbitrage opportunities presented by the current system of disparate rates with the necessity to maintain a rational system of ICC that reflects cost causation, by adopting national target rates that can be achieved in all jurisdictions over a reasonable time.

B. The Commission Should Not Adopt Mandatory Bill-and-Keep.

Several of the plans presented to the Commission call for adoption of a mandatory bill-and-keep system for ICC. Under these proposals, bill-and-keep would be adopted as the default pricing of ICC, regardless of the actual balance of traffic between carriers.

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[45] As NECA stated: "Continued recovery of a reasonable portion of network costs from interconnecting carriers helps avoid creating uneconomic incentives that may drive up end user rates and/or demand on universal service funds." NECA Comments, p. 11.

For example, ICF, IWC and CTIA all propose some form of bill-and-keep as the eventual end point of ICC reform.[46] An even larger and more diverse group of commenters, however, spoke out against Commission adoption of a mandatory bill-and-keep regime for ICC.[47] These carriers and consumers alike were united in pointing out the manifold flaws inherent in a mandatory bill-and-keep intercarrier compensation system. A mandatory bill-and-keep regime would:

- interfere with the development of rational commercial relationships;
- fail to recognize the economic cost of interconnection;
- impose unreasonable costs on small incumbent LECs;
- violate the provisions of Section 252(d)(2) of the Act that ICC rates provide for recovery of the additional costs of terminating mutually exchanged traffic;
- not be the least obtrusive or disruptive solution to the arbitrage problems presented by the current regime of widely varying ICC rates; and
- in and of itself, create arbitrage opportunities at least as great as the current system of widely varying ICC rates.

In short, bill-and-keep has been presented by its proponents as a straightforward and permanent solution to the issue of ICC,[48] when in reality it is a scheme with more baggage than the status quo. While there is no doubt that problems exist with the current

[46] ICF Comments, pp. 25-29; IWC Comments, pp. 7-10; CTIA Comments, pp. 9-11.

[47] *Carriers*: ANPA Comments, pp. 8-9; BellSouth Comments, pp. 9-12; Comporium Comments, pp. 5-6; CenturyTel Comments, pp. 19-25; ERTA Comments, pp. 5-6; Frontier Comments, pp. 5-9; Iowa Network Services Comments, p. 7; KMC Comments, pp. 28-31; Pac-West Comments, pp. 32-46; SureWest Comments, pp. 13-14; TDS Comments, p. iii; TWT Comments, pp. 19-35; Verizon Comments, p. 6; XO Comments, pp. 13-16. *Associations and Consultants*: CCG Comments, pp. 7-8; CCBAP Comments, pp. 11-12; CTA Comments, pp. 7-8; Ionary Comments, pp. 10-11; MIC Comments, pp. 16-21; NTCA Comments, pp. 17-23; SBA Comments, pp. 7-8; SDTA Comments, p. 1; TCA Comments, pp. 7-8; *Regulators*: InURC Comments, pp. 4-9; NDPSC Comments, pp. 2-3. *Consumers*: NASUCA Comments, pp. 7-10; NJRPA Comments, pp. 4-5; TxOPC Comments, pp. 9-10; WyOCA Comments, pp 6-10.

[48] ICF Comments, pp. 26-27; IWC Comments, pp. 9-11.

system of varying ICC rates, mandatory bill-and-keep is not the answer. The Commission should take the opportunity presented by this proceeding to continue past progress toward reducing the disparity among ICC rates, but it should definitely not take the drastic and counterproductive step of adopting mandatory bill-and-keep as the end point of ICC reform.

As is obvious from a review of the filed comments, the foremost proponent of a mandatory bill-and-keep system of ICC is ICF. While ICF purports to include a range of telecommunications providers, the remaining proponents of bill-and-keep schemes tend to be wireless carriers.[49] Presumably this is because wireless carriers have by and large avoided making access payments under the rules of the current intercarrier compensation system, and they would like to keep it that way. In fact, the extensive intercarrier payments made by and to landline carriers for long distance calls compared to the lack of such payments made by and to wireless carriers for the same type of call, illustrates one of the bases for the arbitrage complaints generated by the current system.

While virtually all parties agree that the current system of ICC needs to be changed to minimize such arbitrage opportunities, the proponents of the move to a mandatory bill-and-keep system of compensation have failed to make the case that bill-and-keep will result in a better solution than the current system. Starting with the premise that different treatment of the same functionality and widely varying rates for ICC present opportunities for arbitrage and gaming of the system, proponents of mandatory bill-and-keep then make the insupportable leap to the conclusion that

[49] CTIA Comments, pp. 10-21; IWC Comments, p. 11; Leap Comments, pp. 4-5; Nextel Comments, p. 32; RCA Comments, pp. 2-3; Sprint Comments, pp. 2-12; T-Mobile Comments, pp. 8-18; U.S. Cellular Comments, pp. 5-8. See also, NCTA Comments, pp. 3-11; Qwest Comments, pp. 8-22; VeriSign Comments, pp. 8-9.

elimination of these problems requires elimination of positive ICC rates though adoption of a zero default rate for most traffic. What the proponents of mandatory bill-and-keep never address are the equally perverse incentives to overuse the networks of other carriers that will be created by reducing most usage rates to zero. As NECA noted: "To the extent that pool members are forced to charge low rates (or no rates) for intercarrier traffic, interconnecting carriers could be expected to redirect traffic to lower-priced substitute services (*e.g.,* from special to switched access) that may not necessarily be the most efficient, thus driving up and/or shifting network costs to other users."[50]

NASUCA agrees with Verizon that virtually all of the benefits claimed for bill-and-keep in reality flow from the elimination of the disparity in ICC rates.[51] Currently, ICC rates range from almost $0.36 per MOU to zero per MOU,[52] with the highest rates being charged by rural carriers in the intrastate jurisdiction. On the other hand, the interstate access charges of price cap carriers fall in a narrow range, from $0.0055 per MOU to $0.0095 per MOU. NASUCA proposes to extend this same narrow range to most ICC rates, interstate and intrastate. ICC rates below this range would not be affected.

As a result, all rates for ICC would be moved much closer together over a five-year period. Inequities stemming from widely varying rates for the same functionality would be eliminated. Temptations to mislabel or re-route traffic to take advantage of wildly disparate ICC rates would be correspondingly reduced. At the same time,

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[50] NECA Comments, p. 11.

[51] Verizon Comments, p. 4.

[52] ICF Comments, App. E, p. 2.

incentives to voluntarily enter into bill-and-keep arrangements when it is in the interests of all parties will be increased. These benefits can be achieved with the least disruption to customers and the telecommunications industry by adopting NASUCA's plan of declining ICC target rates.

IV. LEGAL ISSUES

A. The Commission Cannot Preempt State Authority Over Intrastate Access Charges.

A linchpin of all the plans to adopt mandatory bill-and-keep is preemption of state authority over intrastate access charges. However, the initial comments -- including those asserting the Commission has statutory jurisdiction and "mixed use" doctrine authority to regulate intrastate switched access charges -- demonstrate conclusively that the Commission does *not* have such authority. Several commenters carefully explain how the plain language of Sections 152, 201, 251(b)(5) and (i), and 252(d)(2) of the Act show conclusively that Congress did not transfer jurisdiction of intrastate switched access service from the states to the Commission.[53] Commenters who assert that Congress did transfer such jurisdiction to the Commission base their assertions on: (1) strained "interpretations" of unambiguous language; (2) disregard of related statutory provisions which refute their assertions; and (3) disregard of indisputable facts.[54]

[53] This group includes the Maine and Vermont PSCs, NARUC, NASUCA, NY DPS, Ohio PUC and Verizon.

[54] This group includes ICF, MIC, Qwest, SBC, Time Warner, Sprint, USTA and VeriSign.

It is, of course, undisputed that Congress, in Section 152(b) of the Act, denied the Commission jurisdiction of intrastate telecommunications.[55] Congress went so far as to include in its denial of intrastate jurisdiction a rule of statutory construction prohibiting construction of anything in the Act to give the Commission jurisdiction over intrastate service.[56] That is, Section 152(b) not only denies the Commission jurisdiction over intrastate service, but also prohibits *interpretation* of any other provision in the Act as a grant of jurisdiction over intrastate telecommunications. The necessary result is that exceptions to the explicit denial of Commission jurisdiction over intrastate telecommunications contained in Section 152(b) must be expressly stated in the Act.

The 1996 Act created express exceptions to the denial of intrastate jurisdiction found in Section 152(b), but jurisdiction over intrastate switched access charges was not one of them.[57] Nevertheless, commenters advocating preemption insist that Section 251(b)(5) transferred jurisdiction of intrastate switched access from the states to the Commission.[58] Similarly, at paragraph 79 of the FNPRM the Commission stated that Section 251(b)(5) "on its face, applies to all telecommunications." Although the word "telecommunications," standing alone, may mean all telecommunications, the use of the word in Section 251(b)(5) cannot be construed by itself or standing alone. Rather, it must be read and understood in the context of the entire Act, including the remaining words in

55 47 U.S.C. 152(b):"…nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier…"

56 *Louisiana PSC v. FCC*, 476 U.S. 355, 377 (1986).

57 *A.T.&T. Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378-82 and n.8 (1999) ("Congress, by extending the Communications Act into local competition, has removed a significant area from the States' exclusive control. Insofar as Congress has remained silent, however, § 152(b) continues to function.")

58 ICF Comments, pp. 37-48.

Section 251(b)(5), as well as the language of Section 152(b) which denies intrastate jurisdiction to the Commission and governs construction of the entire Act.

Commenters advocating preemption ignore the relevant terms of Sections 152(b), 251(b)(5), and 252(d)(2), and, as result, violate (and invite the Commission to violate) the explicit prohibition against construing any part of the Act to give the Commission jurisdiction over intrastate communications. ICF, for example, does not mention Section 152(b) even once in its explanation of the alleged transfer of jurisdiction over intrastate switched access charges from the states to the Commission under Section 251(b)(5).[59] This omission is entirely understandable, since Section 152(b) stands as an insurmountable barrier to ICF's arguments.

ICF contends that Section 251(b)(5) makes no distinction between interstate and intrastate telecommunications.[60] This is true, but there was no need to repeat the distinction between interstate and intrastate telecommunications in Section 251(b)(5). That distinction appears explicitly in Section 152(b) and applies to the entire Act in the absence of an express exception. As the D.C. Circuit Court of Appeals stated:

> While the apportionment of regulatory power in this dual system is, of course, subject to revision, whether the Commission may preempt state regulation of intrastate telephone service depends, as in "any pre-emption analysis," on "whether Congress intended that federal regulation supersede state law." The "best way" to answer that question, the Supreme Court has instructed, "is to examine the nature and scope of the authority granted by Congress to the agency." In cases involving the Communications Act, that inquiry is guided by the language of section 152(b), which the Supreme Court has interpreted as "not only a substantive jurisdictional limitation on the FCC's power, but also a rule of statutory construction."[61]

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[59] *Id.*

[60] *Id.*, p. 38.

[61] *New England Pub. Comm. Council v. FCC*, 334 F.3d 69, 75 (D.C. Cir. 2003) (citations omitted).

ICF also contends that Section 251(b)(5) makes no distinction between the service definition, e.g., exchange access or exchange service, included in the word telecommunications, thus extending the FCC's jurisdiction to all services.[62] In fact, there is such a distinction that is readily apparent from reading the entire statement of the duty imposed on LECs by Section 251(b)(5).

The words "reciprocal compensation" distinguish the telecommunications service governed by Section 251(b)(5), e.g., local service, from service not governed by Section 251(b)(5), i.e., exchange access. Section 251(b)(5) imposes a duty on LECs to "establish reciprocal compensation arrangements." ICF does not explain how the compensation paid by an IXC to a LEC for the origination or termination of an interstate or intrastate toll call can be "reciprocal."[63] ICF's omission was unavoidable, because switched access is not reciprocal.

Section 252(d)(2) sets forth the pricing standards applicable to reciprocal compensation, and only reciprocal compensation, under arrangements made by LECs pursuant to Section 251(b)(5). In particular, the pricing standards provide for the recovery of the costs of transport and termination of "calls that originate on the network facilities of the other carrier."[64] Toll calls do not originate or terminate on an IXC's interexchange network, and LECs do not compensate IXCs for such non-existent service.

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[62] ICF Comments, p. 38.

[63] The absence of the word "origination" in the identification of services for which Section 251(b)(5) imposes a duty on LECs to establish reciprocal compensation arrangements reinforces the conclusion that the section does not apply to switched access service provided to IXCs by LECs. Switched access charges typically apply to both origination and termination, as both cause the LEC to incur costs to provide the service. It would make no sense to consider the absence of the word "origination" in Section 251(b)(5) as a subtle or cryptic prohibition of LECs charging IXCs originating switched access charges for toll calls.

[64] 47 U.S.C § 252(d)(2)(A)(i).

"Reciprocal compensation," therefore, necessarily excludes exchange access (switched access) from the telecommunications service addressed in Section 251(b)(5).

ICF also claims that Section 251(g) confirms that Section 251(b)(5) applies to switched access, both intrastate and interstate.[65] The Commission rejected this claim in the *ISP Remand Order*.[66]

Further, legislative history dispels any lingering notion that Congress, with little fanfare, transferred jurisdiction over intrastate switched access charges from the states to the Commission in Section 251(b)(5).[67] Even if Congress did alter the authority of the FCC and the states with regard to switched access charges, it did so in a manner far different than that envisioned by commenters who argue the Commission now has the authority to regulate both intrastate and interstate switched access. As explained by Verizon, Congress gave the Commission the duty to establish pricing standards consistent with the Act, but the states were given the duty under Section 252 to ultimately approve prices for interconnection under Section 251, subject to appeal in the federal courts.[68] If switched access is a service for which reciprocal compensation arrangements must be established under Section 251(b)(5), the States must approve the prices for both intrastate and interstate switched access, under Section 252(d). Congress did not intend -- nor did it achieve -- this result.

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[65] ICF Comments, pp. 41-43.

[66] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996: Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 96-98, 16 FCC Rcd 9151, 9166-9170 (2001) (¶¶34-39) ("*ISP Remand Order*").

[67] MePUC/VtPSB Comments, pp. 8-9; NARUC Comments, pp. 8-11.

[68] Verizon Comments, pp. 38-40.

In initial comments, NASUCA explained how the Commission could not rely on the "mixed use" doctrine (where traffic is treated as jurisdictionally interstate if it is impossible or impractical to separate the interstate and intrastate components[69]) for the authority to preempt state regulation of intrastate switched access charges.[70] Several commenters agree that the circumstances under which the Commission could rely on the "mixed use" doctrine for authority are not present here, since carriers can and do separately identify (or categorize) traffic as interstate or intrastate, and have done so since the inception of access charges.[71] The Ohio PUC points out that the Commission cannot reasonably conclude after decades of separation that interstate and intrastate access services have "suddenly become inseparable."[72] Nothing has changed which would provide a basis for asserting preemptive authority under the "mixed use" doctrine

Some commenters point out that the Commission itself has been careful in the past to note the limit of its authority to regulate "interstate" but not "intrastate" access services.[73] The Commission cannot now decide to preempt the states' recognized authority merely because the Commission thinks that action will best effectuate a federal

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69 See FNPRM, ¶80.

70 NASUCA Comments, pp. 39-40.

71 NARUC Comments, p. 12-13; MePUC/VtPSB Comments, p. 12; PUCOh Comments, p. 4-5.

72 PUCOh Comments, p. 4-5. Other commenters suggest caution in justifying Commission preemption on this ground. Verizon, which argues that the Commission "can reasonably assert" preemption over intrastate access, can only claim that inseparability concerns relied upon by the Commission in recent cases concerning VoIP and wireless traffic, may "increasingly" apply in the future to all telecommunications traffic. Verizon Comments, p. 37. CBI admits that the Commission "would have to make a compelling case that no intrastate traffic is separately identifiable before it could preempt all state access rules." CBI Comments, p. 15. Both Verizon and CBI suggest the Commission seek authority from Congress.

73 NY PSC Comments at 9; Mo PSC Comments at 12-13; PUCOh Comments, p. 3-4, 9. See for example, *ISP Remand Order*, 16 FCC Rcd at 9169-9170 (¶39): ("These [251(g) access] services remain subject to Commission jurisdiction under Section 201 (or to the extent they are intrastate services, they remain subject to the jurisdiction of state commissions….").

policy. The Supreme Court has made it clear: "An agency may not confer power upon itself. To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress."[74] Clearly, under the current wording of the Act, the Commission cannot preempt state statutory authority over intrastate access charges.

In the end, it is not necessary for the Commission to assert such sweeping preemptive authority to undertake meaningful intercarrier compensation reform. One of NASUCA's guiding principles, expressed in the initial comments, is to recognize the appropriate role of states in setting rates charged to end-user consumers in each state. NASUCA's ICC proposal preserves the existing federal/state jurisdictional dichotomy: The FCC would exercise control over interstate rates and provide guidance to the states about annual target ICC rates; the states would achieve those target rates by exercising control over intrastate local and access rates.

B. Forbearance Is Not Appropriate.

NASUCA observed in its initial comments that forbearance from the requirements of Section 251(b)(5) would be required in order to institute a mandatory bill-and-keep regime. However, forbearance from enforcing Section 251(b)(5) is not possible, because the criteria in Section 160(a) of the Act have not been met.[75] Specifically, enforcement

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[74] *Louisiana PSC v. FCC*, 476 U.S. 355, 374-75 (1986).

[75] 47 U.S.C. 160(a): "[T]he Commission shall forbear from applying any regulation or any provision of this chapter to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets, if the Commission determines that -

(1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that

of Section 251(b)(5) -- the obligation of local exchange carriers to establish reciprocal compensation arrangements -- is necessary to ensure that compensation for services and practices are just, reasonable, and not unjustly or unreasonably discriminatory. In addition, forbearance from applying the statue would be inconsistent with the public interest. The reciprocal compensation arrangements required by Section 251(b)(5) promote competition by providing cost-based compensation for the use of a carrier's network, thus ensuring efficient investment in and reliability of the network, and protecting consumers who use and rely on the network by sending proper price signals to the network users and enhancing public safety.

Time Warner Telecom ("TWT") highlights the inclusion of Section 251(b), and, by extension, Section 252(d)(2) -- the state authority to determine to determine just and reasonable rates based on cost -- in Section 251(c).[76] Section 160(d) of the Act prohibits forbearance by the FCC with respect to Section 251(c) until the Commission determines that the section is fully implemented.[77] TWT correctly states that the Commission has made no determination that Section 251(c) is fully implemented.[78]

TWT also illustrates NASUCA's point that ensuring the recovery of costs, or adequate compensation, from the cost causer through reciprocal compensation as

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telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;

(2) enforcement of such regulation or provision is not necessary for the protection of consumers; and

(3) forbearance from applying such provision or regulation is consistent with the public interest."

[76] TWT Comments, p. 22. Section 251(c) of the Act imposes additional obligations on ILECs, such as the duty to provide interconnection and collocation.

[77] 47 U.S.C. 160(d): "Limitation. – Except as provided in section 251(f) [the rural exemption], the Commission may not forbear from applying the requirements of section 251(c) or 271 under subsection (a) of this section until it determines that those requirements have been fully implemented."

[78] *Id*.

contemplated by the statute allows just and reasonable rates that will protect carriers, consumers, and the public interest.[79] The requirements of this section ensure that financially healthy carriers will continue to provide telecommunications services to the public, including the services that are essential for public safety and network dependability. Any consideration of forbearance from the enforcement of the reciprocal compensation requirement reflected in Section 251(b)(5), in favor of a *non-cost-based* bill-and-keep regime will create distortions that will hinder a competitive system. Forbearance would also be contrary to the requirement for just and reasonable compensation for all carriers. This is because a non-cost-based bill-and-keep regime does not adequately compensate all carriers for the use of their networks. Such a system would essentially encourage discriminatory practices that would impede competition in the market and decrease the reliability and dependability of the network overall, hindering public safety, and otherwise harming consumers.

NASUCA reiterates that the *reciprocal* compensation arrangements required by Section 251(b)(5) provide for the *mutual* recovery of costs between two carriers.[80] Forbearance from enforcing a carrier's duties to establish reciprocal compensation arrangements would defeat the specific purpose of the statute, which imposes the duty to establish a cost-based arrangement for compensation, thereby ensuring efficient investment, promoting public safety, and protecting consumer interests.

A mandatory bill-and-keep regime would not produce the cost-based rates contemplated in the Act unless all network traffic throughout the nation is roughly

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[79] *Id.*

[80] Reciprocal: Given or owned mutually as between two person; interchanged. Reciprocal obligations are those due from one person to another and vice versa. Black's Law Dictionary, Fifth Edition, p. 1141.

balanced between carriers. The simple fact is that network traffic is not roughly balanced between all carriers, and mandatory bill-and-keep would not encourage -- let alone effectuate -- such a balance. In such circumstances, adoption of mandatory bill-and-keep would prevent adequate cost recovery for many carriers. It is hard to see how any party could argue that a section of the Act intended to ensure that customers, carriers, and the network benefit from the efficiencies of properly aligning the costs and compensation in a market moving toward competition, should be effectively repealed pursuant to Section 160(a). Forbearance would allow the imposition of a mandatory bill-and-keep regime that does not provide for mutual recovery of costs, does not recover costs from the cost-causer, and would significantly reduce recovery of costs for those providers that transport traffic over large distances or terminate more traffic than other carriers. Forbearance from enforcement of Section 251(b)(5) would directly contradict the purposes of the Act.

In addition, NASUCA agrees with the Rural Alliance that in the absence of a factual record that demonstrates that the criteria in Section 160(a) of the Act are met, forbearance from Section 251(b)(5) cannot, and should not be considered in this proceeding.[81] To the contrary, the evidence shows that continued enforcement of Section 251(b)(5) is essential to perpetuate a sensible compensation regime that is consistent with the purposes of the Act.

Several parties responded to the FCC's request for comments regarding whether it should forbear from enforcement of Section 254(g) absent unified access charge reform.[82] The comments note that forbearance from Section 254(g) would harm consumers and the

[81] Rural Alliance Comments, p. 29.

[82] FNPRM at ¶¶ 83- 86.

public interest in general by hindering communication of consumers that rely on access as a link to emergency services,[83] and that the public interest benefits from enforcement of 254(g) outweigh alleged competitive disparities.[84]

The State of Hawaii's comments support NASUCA's initial comments regarding the public interest benefits of one-stop-shopping in today's market.[85] Forbearance from enforcement of Section 254(g) is not appropriate because of the potential for consumer harm if the section is not enforced. NASUCA also notes that a factual record has not been developed in this proceeding demonstrating that the criteria in Section 160(a) of the Act have been met regarding forbearance from Section 254(g).

V. INTERCARRIER COMPENSATION RATES SHOULD REFLECT THE DECLINING COST OF ACCESS.

A. The Cost of Access Is Declining.

This proceeding must be seen in the context of past Commission actions to move ICC rates, primarily interstate interexchange access rates, toward cost, and to adopt a rational rate structure for recovery of costs. A necessary underpinning of past Commission's orders was an assumption that the costs of access are declining; that is, introduction of digital, and later packet switching, has resulted in lower traffic-sensitive costs over time.[86] In 1989 the Commission introduced a price cap regime for larger carriers as a way to provide an incentive for carriers to reflect these cost reductions in

[83] RCA Comments, p. 7.

[84] Hawaii Comments, p. 4.

[85] NASUCA Comments, p. 45; Hawaii Comments, pp. 2-4.

[86] See, TxOPC Comments, pp. 8-9. The advent of fiber interoffice trunking has also reduced per unit transport costs.

access pricing. Subsequent Commission actions to expand and perfect these price caps have resulted in lower access rates over time and benefited consumers.

The most recent Commission actions to reform access charges -- the *CALLS* and *MAG* Orders[87] -- were continuations of long-standing Commission policy to reduce and rationalize access pricing.[88] In this proceeding the Commission must address the disparities in ICC rates that have now become unsustainable in an increasingly competitive, multi-platform telecommunications environment. In order to bring more uniformity to ICC, the Commission must address the access obligations and pricing of the entire telecommunications industry, rather than treating different types of carriers in discrete, separate proceedings. This means the Commission will have to reduce the interstate rates of rural carriers, provide guidance to the states on the pricing of intrastate access, and clarify the application of ICC rates to wireless carriers and ISPs. To this end, the Commission should continue its policy of reflecting the cost reductions of access in lower access rates by adopting NASUCA's recommended target rates, and establishing these rates as targets for the states as well. Presumably, these lower ICC rates will be passed on to end users.

On the other hand, it makes no sense to reform ICC rates by raising end user rates by automatic increases in the SLC cap as recommended by several parties.[89] Such an action would be counter to the movement to lower access charges over the past 15 years,

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[87] *In the Matter of Access Charge Reform*, CC Docket No. 96-262, 15 FCC Rcd 12962 (2000) ("*CALLS Order*"); *In the Matter of the Multi-Association Group Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, 16 FCC Rcd 19613 (2001) ("*MAG Order*").

[88] Indeed, some may argue that given the expiration of the five-year *CALLS* plan on June 30, 2005, the previously established price cap regime based on the "X-factor" should be reinstituted.

[89] ICF Comments, App. C., p. 27; BellSouth Comments, p. 28; Qwest Comments, p. 7.

would effectively ignore all productivity gains in the telecommunications industry, and would result in unavoidable rate increases for the vast majority of residential customers, especially low-volume users.

B. ICC Rates Should Be Based on Forward-Looking Costs.

In its 1997 *Access Charge Reform Order* the Commission clearly established forward-looking costs as the ultimate standard for access charge pricing.[90] While the Commission preferred to let competitive pressures drive access charges to economic cost, it made clear that it reserved the right to adjust rates in the future to bring them to forward-looking levels:

> To fulfill Congress' pro-competitive mandate, access charges should ultimately reflect rates that would exist in a competitive market. We recognize that markets are far better than regulatory agencies at allocating resources and services efficiently for the maximum benefit of consumers….Where competition has not emerged, we reserve the right to adjust rates in the future to bring them in line with forward-looking costs.[91]

Because of the subsequent adoption of the *CALLS* and *MAG* Orders which substantially reformed and reduced access charges, the Commission did not require the filing of forward-looking cost studies by carriers.[92] Nevertheless, the Commission saw

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[90] *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing End User Common Line Charges*, Docket No. 96-262, 12 FCC Rcd 15982, 16001-16003 (1997) (¶¶42-50) ("*Access Charge Reform Order*").

[91] *Id.*

[92] The Commission did, however, make clear that it was retaining the forward-looking cost standard for access charges. Carriers that did not voluntarily participate in the *CALLS* plan had the option to submit forward-looking cost studies for the establishment of access charges: "This cost study proceeding is consistent with what we outlined in the *Access Charge Reform Order*. In the *Access Charge Reform Order*, the Commission stated that its goal was for interstate access charges to reflect the forward-looking economic costs of providing interstate access services." *CALLS Order*, 16 FCC Rcd at 12984 (¶¶57-59).

both Orders as a continuation of the process of reduction of access rates toward economic cost.

Several commenters have recommended that the Commission continue this policy as it establishes new ICC rates in this proceeding.[93] NASUCA agrees with these commenters. Establishment of a glide path for achievement of the ICC target rates for all companies and all jurisdictions will minimize disparity and continue movement of ICC rates toward forward-looking costs. This approach would be consistent with past Commission action to reduce CLEC access charges in measured steps:

> Our goal in this process is ultimately to eliminate regulatory arbitrage opportunities that previously have existed with respect to tariffed CLEC access services….[W]e implement the benchmark in a way that will cause CLEC rates to decrease over time until they reach the rate charged by the incumbent LEC. This mechanism will mimic the operation of the marketplace… .[94]

On the other hand, a number of rural carriers and rural carrier organizations urge the Commission to change course and base ICC rates on embedded costs.[95] The Commission should reject these recommendations. In the *CALLS Order*, the Commission recognized that use of embedded costs for determination of access charges was not appropriate: "Regulatory structures that base a firm's allowable rates directly on the reported costs of the individual firm can create perverse incentives, because reimbursing the firm's costs removes the incentives to reduce costs and improve

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[93] MoPSC Comments, pp. 3-4, 9; TWT Comments, p. 7; TxOPC Comments, p. 6.

[94] *In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, 16 FCC Rcd 9923, 9925 (2001) ("*CLEC Access Order*") (¶¶3-4).

[95] IGTC Comments, p. 3; ICORE Comments, pp. 4-7; ITSI Comments, pp. 19-20; MITS Comments, p. 14; Rural Alliance Comments, pp. 34-42.

productive efficiency."[96] In the 2001 *MAG Order* the Commission reformed the access charges of rate-of-return carriers "by rationalizing the access rate structure and driving per-minute rates towards lower, more cost-based levels…."[97] At the same time the Commission declined to move the access charges of rate-of-return carriers all the way to forward-looking costs because of the potential impact on these carriers.[98]

The comments of many rural carriers outline the steps they have taken to install the latest technology in order to bring high quality and advanced services to rural America. The Rural Alliance also recognizes that "[i]f technology allows a service to be provided more efficiently and/or input prices are declining, forward-looking costs will be lower than embedded costs."[99] Nevertheless, the rural commenters continue to insist that they have an absolute right to ICC rates based on recovery of their past investment, i.e., their embedded costs.

Carried to its extreme, the recommendations of the rural carriers would result in differing ICC rates for each carrier, the very situation which has produced some of the arbitrage opportunities under the current system. The Commission should address these disparities by establishing uniform target rates as proposed by NASUCA. The NASUCA proposal recognizes the higher unit costs incurred by rural carriers and establishes a rural target ICC rate of $0.0095, almost twice as high as the target rate for non-rural carriers. While the NASUCA proposal does not move the ICC rates of rural carriers all the way to forward-looking costs, it does continue the incremental steps to lower access rates begun

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[96] *CALLS Order*, 15 FCC Rcd at 12968 (¶13).

[97] *MAG Order*, 16 FCC Rcd at 19616 (¶1).

[98] *Id.*, 16 FCC Rcd at 19650 (¶81).

[99] Rural Alliance Comments, p. 35.

in the *Access Reform Order* and continued in the *CALLS Order*, the *CLEC Access Order* and the *MAG Order*.

C. It Is Appropriate for the FCC to Provide Guidance to the States for the Establishment of Intrastate ICC Rates.

NASUCA's plan recognizes that the Commission and the States each have jurisdiction over different aspects of ICC: the Commission has jurisdiction over interstate rates, while the states have jurisdiction over intrastate access.[100] Under NASUCA's plan this traditional jurisdictional dichotomy would not change. The FCC would establish annual target rates, and all ICC rates above those target levels would be reduced to the target levels. The final target rates at the end of five years would be $0.0055 per minute of use ("MOU") for non-rural carriers and $0.0095 per MOU for rural carriers.

Although the Commission's jurisdiction is limited to interstate rates, the FCC would not concern itself only with interstate rates. One of the biggest problems with the current ICC regime is the widely varying array of ICC rates, and it is generally recognized that intrastate ICC rates are a main culprit in this regard.[101]

In order to reduce the disparity between interstate and intrastate ICC rates, the Commission will have to assume a leadership role: the Commission will have to make the case that minimizing disparity in ICC rates by moving to uniform target rates is in the national interest; the Commission will have to establish those target rates; and the

[100] As previously discussed, under Section 251(b)(5) and 252(d)(2) of the Act, for reciprocal compensation the Commission establishes default rates, but states actually arbitrate and approve specific rates for specific carriers.

[101] ICF Comments, p. 71.

Commission will have to establish the expectation that states will achieve the target rates. Heretofore, the Commission has not established a certain set of ICC rates as a national policy, nor has it stated clearly what is expected of the states. Speaking clearly on the subject of ICC will go a long way toward solving the problem.

Several large carriers fault NASUCA's plan because it does not preempt the states, and therefore contains the possibility that some states will not achieve the target rates by the end of the five-year transition period.[102] NASUCA has already addressed the fact that preemption is not legally permissible in this case. Even if it were, NASUCA does not believe it would be a wise policy. States are responsible for the current level of their intrastate ICC rates. Each state has its own statutory background, regulatory structure and regulatory history. Accordingly, it should be up to each state to get its own house in order in regards to ICC, and in its own way.

NASUCA has no doubt that it will take some states longer to achieve the FCC-established target rates than others. Some states have already begun moving their intrastate rates to interstate levels, while others so far have done nothing. NASUCA also admits that there is a possibility that at the end of the five-year transition period, there may be a few stragglers that will have not yet attained the target levels. Nevertheless, NASUCA has every confidence that the vast majority of states will arrive at the final target rate by the target date.

In this regard, establishment of federal guidelines for ICC to be used by the states is not dissimilar to UNE pricing standards. Although use of these guidelines was not mandatory, by and large states followed the guidelines established by the FCC. The same

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[102] ICF Comments, p. 67; BellSouth Comments, p. 15; Verizon Comments, p. 24.

approach was taken in the recently released guidelines for designation of eligible telecommunications carriers.[103] In order for the Commission to monitor the states' progress in attaining the target goals, the FCC may want to require annual reports from states detailing actions taken to achieve the target rates. NASUCA believes that leadership by the FCC in explaining and establishing target ICC rates is preferable to the two extremes of doing nothing as advocated by Verizon, and radically overthrowing the currently established division of jurisdiction between the states and federal governments as advocated by proponents of mandatory bill-and-keep, such as ICF.

D. A Future Move to Capacity-based ICC Pricing May Be Justified.

With its initial comments, NASUCA submitted the affidavit of Dr. David Gabel which showed that although switching costs remained traffic-sensitive, it would be appropriate to move to a capacity-based pricing system for such costs in the future.[104] Other commenters, including some rural carriers, also agreed that changes in technology make capacity-based pricing appropriate:

> Cost recovery that properly reflects cost causation in the current environment must shift to technologically neutral capacity and connection based charges. With packet switching replacing circuit switching, it is difficult to ascribe specific facilities to specific calls. The overall capacity of the network to complete calls is what matters. Capacity charges should fall on carriers, as access charges do today, which carriers can recover from their customers, as they do today.[105]

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[103] *In the Matter of Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, FCC 05-46 (Rel. March 17, 2005).

[104] NASUCA Comments, p. 27; id., Att. 4, Gabel Affidavit, p. 45.

[105] TxOPC Comments, p. 8. See also CCBAP Comments, pp. 11-23; Comporium Comments, pp. 6-7; Frontier Comments, pp. 2, 7; Ionary Comments, pp. 14-15; Nextel Partners Comments, pp. 11-12; SBA Comments, pp. 13-14; NTFIC *Ex Parte* (May 17, 2005), p. 6; EPG *Ex Parte* (Nov. 2, 2004), pp. 7-8, 29-33.

Following a phase-down to final ICC minute-of-use ("MOU") target rates, a transition to capacity-based ICC pricing would create a simpler, more uniform, less disparate ICC rate structure.[106]

Several rural carriers opposed adoption of capacity-based ICC rates.[107] These carriers favor retention of MOU ICC rates "[b]ecause different carriers originate and terminate different amounts of traffic, [and] cost allocation and billing should recognize the differing amounts of usage that each carrier imposes on Rural ILEC infrastructure."[108]

Capacity-based pricing of ICC will continue to recognize the different demands placed on networks by different carriers. However, movement to a capacity-based regime will be consistent with the fact that over time more of each network's costs will be related to the cost of interconnection. Actual usage will still be an important pricing factor, especially in terms of a particular carrier's usage at the network peak hour. Because movement to capacity-based pricing should happen at the end of the five-year phase-down to ICC target rates, the Commission should start a proceeding subsequent to the order in this case to explore the appropriate ICC rate structure at the end of the phase-down period.

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[106] The rate structure for ICC rate recovery does not necessarily dictate rate recovery from end users.

[107] ICORE Comments, p. 7; NTCA Comments, p. 6; Pac-West Comments, p. 15-16.

[108] ICORE Comments, p. 7.

VI. THE COMMISSION SHOULD NOT GUARANTEE RECOVERY OF LOST REVENUES.

A. Introduction

The plans proposed by all parties call for reductions in the existing levels of both interstate and intrastate access charges as a means of minimizing the disparity among various intercarrier compensation rates. Reductions in access charges will necessarily result in a reduction in revenues for carriers, all other things being equal. The reaction to this loss of revenue as a result of ICC reform varies widely among the parties. For example, NASUCA, organizations representing customer interests and others argued against automatic or guaranteed recovery of revenue lost as a result of access charge reductions.[109]

As set forth in its initial comments, NASUCA believes that carriers should be allowed additional revenues to replace lost ICC revenues only upon a showing of need for such revenues. The showings required would vary depending on the jurisdiction within which the access reductions occurred. For example, under NASUCA's proposal, large price cap carriers would not likely need to reduce their existing interstate access charges. As a result, there would not be any need for replacement revenues for those carriers in the interstate jurisdiction.[110] On the other hand, these carriers may have to

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[109] See, NASUCA Comments, pp. 28-33; CompTel/ALTS Comments, pp. 7-8; Ad Hoc Comments, pp. 10-18; Cox Comments, pp. 11-13; CTIA Comments, p. 31; MoPSC Comments, pp. 24-27; NJRPA Comments, pp. 9-10; NYDPS Comments, pp. 6-7; NCTA Comments, pp. 4-5, 8-9; TxOPC Comments, p. 9; Pac-West Comments, pp. 49-50.

[110] Small, rural carriers would have revenue reductions in the interstate jurisdiction as a result of lowering their interstate access charges. NASUCA has proposed that a portion of the revenues lost by these small carriers be recovered through the federal Universal Service Fund, using the existing ICLS mechanism for revenues related to non-traffic sensitive costs, and a modified Local Switching Support mechanism for revenues related to traffic-sensitive costs.

reduce intrastate access charges in some states over the next five years in order to bring intrastate access rates to the same level as interstate charges. The manner and pace of these access reductions -- as well as whether some or all of the revenue lost as a result of the reductions should be replaced -- would be up to the regulatory agency with authority over those intrastate rates.[111]

Not surprisingly, carriers large and small call for automatic recovery of lost access revenues as part of any reform of ICC rates.[112] This automatic recovery usually takes the form of increases in the federal SLC, and is usually on a dollar-for-dollar basis based on some locked-in past period. The self-interest motivating these arguments is entirely understandable: given the choice, most carriers would rather have more revenue than less, and would rather receive replacement revenues automatically rather than have to show a need for such revenues. However, there is no requirement in the law or public policy that the Commission replace revenues lost as a result of ICC rate reductions. The Commission's charge under Section 201(b) of the Act is to establish "just and reasonable" rates. Courts have historically given the Commission wide latitude in prescribing rates in the interstate jurisdiction.[113]

[111] Contrary to Verizon's assertion**,** NASUCA does **not** "assume that all carriers -- in all markets -- can pass on to consumers a substantial portion of the costs currently recovered through intercarrier compensation." Verizon Comments, p. 6. NASUCA's proposal would not reduce Verizon's interstate revenues since Verizon has already achieved the ICC target rate of $0.0055 per MOU as a result of the *CALLS* Order. While it is likely that Verizon's intrastate revenues will be reduced in particular states in order to achieve the target rate, there are plenty of mechanisms available to state regulatory authorities -- currently and under NASUCA's plan -- to address Verizon's specific situation in each state.

[112] See, Verizon Comments, p. 25-29; BellSouth Comments, p. 18; Qwest Comments, pp. 7, 25-27; Century Tel Comments, pp. 17-19; CBI Comments, pp. 12-13; ICF Comments, App. C, pp. 27-28; JSI Comments, pp. 4-16; TDS Comments, pp. 25-28; XO Comments, pp. 16-20.

[113] See generally, *National Rural Telecom Assn. v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

B. There is No Constitutional or Statutory Requirement To Replace Lost Revenues.

Verizon and Qwest both argue that case law requires that any revenue reduction caused by regulatory action must be replaced dollar-for-dollar on a revenue neutral basis,[114] citing to the United States Supreme Court decisions in *Hope*[115] and *Duquesne*[116] to support their assertions. Verizon and Qwest's arguments are entirely specious. Far from holding that carriers have a right to revenue neutrality when rate changes are made, the *Hope* and *Duquesne* cases -- and a host of other cases -- support NASUCA's position that carriers have a right to additional revenue only upon a showing of need for such revenue.[117]

In *Hope*, the Supreme Court upheld a reduction in Hope Natural Gas Company's rates by the Federal Power Commission ("FPC"). The Court stated:

> The ratemaking process under the Act, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case [315 U.S. at 590] that "regulation does not insure that the business shall produce net revenues."[118]

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114 Verizon Comments, pp. 26-27; Qwest Comments, pp. 25-27.

115 *Federal Power Commission v. Hope Natural Gas Co*., 320 U.S. 591 (1944).

116 *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

117 In this regard NASUCA wholeheartedly endorses NCTA's statement of the issue: "The Commission should be skeptical of any claim that current recipients of intercarrier compensation are entitled to be 'kept whole.' They are not. The pertinent legal requirement is that the Commission's regulatory actions not result in earnings that are so low as to be confiscatory. There is no basis to conclude that any carrier's rate of return on investment from services under the Commission's jurisdiction are so low that revenue reductions arising from resolving intercarrier compensation will result in confiscation." NCTA Comments, pp. 4.

118 *Hope*, 320 U.S. at 603.

> [I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry … is at an end.[119]

A year later, in the case of *Colorado Interstate Gas Co. v. Federal Power Commission*, 324 U.S. 581 (1945), the Supreme Court again upheld the actions of the FPC in lowering a utility's previously established rates. Justice Douglas, writing for the Court, reviewed prior cases and stated:

> In those cases we held that the question for the courts when a rate order is challenged is **whether the order viewed in its entirety and measured by its end results meets the requirements of the Act**. That is not a standard so vague and devoid of meaning as to render judicial review a perfunctory process. It is a standard of finance resting on stubborn facts. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business.[120]

In 1968, in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the Supreme Court again addressed the courts' role in reviewing the action of a federal regulatory commission which lowers rates. The Court made clear that

> no constitutional objection arises … because the value of regulated property is reduced as a consequence of regulation. **Regulation may, consistent with the Constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the Constitutional calculus of reasonableness.**[121]
>
> …
>
> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they "maintain … credit and … attract capital.[122]

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[119] *Id.*, 320 U.S. at 602.

[120] 324 U.S. at 605 (citations omitted; emphasis added).

[121] 390 U.S. at 769 (emphasis added).

[122] 390 U.S. at 791.

In *Duquesne*, the U.S. Supreme Court once again applied the oft-repeated rule that regulatory commissions are not bound by any single method in determining utility rates:

> The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties. Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding. **The Constitution protects the utility from the net effect of the rate order on its property**. … *Hope* clearly held that "the Commission was not bound to the use of any single formula or combination of formulae in determining rates." 320 U.S. at 602. … The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.[123]

Verizon cites to a portion of the *Duquesne* decision where the Court stated that a "decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions."[124] Suffice it say that continuing the reductions in access charges started by the Commission in 1989, and followed in the *CALLS* and *MAG* Orders is not an arbitrary switch in methodologies. In the *Verizon* case,[125] the Supreme Court rejected arguments based on *Duquesne* that adoption of TELRIC methodology was confiscatory because it was an arbitrary switch of methodologies: "[T]o the extent that the incumbents argue that there was at least an expectation that some historically anchored cost-of-service method would

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[123] *Duquesne*, 488 U.S. at 314-316 (footnote omitted) (emphasis added).

[124] Verizon Comments, p. 26, citing *Duquesne,* 488 U.S. at 315.

[125] *Verizon v. FCC*, 535 U.S. 467 (2002).

set wholesale lease rates, no such promise was ever made."[126] Moreover, the Courts have previously upheld the Commission's price cap regime, which resulted in annual reductions in carriers' access charges *without any explicit revenue replacement*.[127]

In *Hope*, the U.S. Supreme Court held: "Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return…."[128] In this proceeding, no carrier has made a claim that reduction of ICC revenues will result in a constitutionally insufficient bottom line. Nor do the ICC rate reductions called for in the NASUCA plan constitute "a new regulatory structure…that affirmatively impedes the ability of affected carriers to recover those revenues from other sources."[129] Even if ICC revenues are reduced, each carrier in each jurisdiction will continue to have recourse to existing revenue recovery mechanisms. Whether these carriers are entitled to additional revenues from local rates or state and federal universal services funds will be a matter of fact to be determined for each carrier.

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126 *Id.*, 535 U.S. at 528.

127 *National Rural Telecom Assn. v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993) ("T]he FCC in 1989 concluded that price cap regulation would on balance be an improvement over rate of return in terms of meeting its statutory goals."); *USTA v. FCC*, 79 F.3d 1195, 1198 (D.C. Cir. 1996) ("Price cap regulation is intended to provide better incentives to the carriers than rate of return regulation, because the carriers have an opportunity to earn greater profits if they succeed in reducing costs and becoming more efficient."); *Verizon v. FCC*, 535 U.S. 467, 487 (2002) ("[Price caps] give companies an incentive 'to improve productivity to the maximum extent possible,' by entitling those that outperform the productivity offset to keep resulting profits. [Citation omitted.] Ultimately, the goal, as under the basic prudent-investment rule, is to encourage investment in more productive equipment.").

128 320 U.S. at 605.

129 Qwest Comments, pp. 25-26.

In this regard, Verizon's description of NASUCA's plan appears to be based either on misunderstanding or intentional mischaracterization. Verizon states: "NASUCA's proposal provides no opportunity for carriers to recover the costs currently recouped through intercarrier compensation… while providing no alternative federal mechanism for the recovery of those costs."[130] As previously discussed, Verizon is simply wrong. Under the NASUCA plan, non-rural carriers would not have to reduce interstate rates below the current *CALLS* target rates. As a result, there would not be a need for any revenue replacement for these carriers in the interstate jurisdiction. Most rural carriers would have to reduce interstate rates, but would have recourse to Interstate Common Line Support ("ICL") for recovery of non-traffic sensitive costs, and to revised Local Switching Support ("LSS") for recovery of traffic-sensitive costs. Recovery of foregone revenue in the intrastate jurisdiction would be the province of each state, with the assistance of the proposed State Inducement Fund.[131] NASUCA's plan provides each carrier a **reasonable opportunity** -- not a guarantee -- to recover any revenues lost as a result of reduction of ICC rates. However, such recovery is not automatic, as the carriers would prefer. Whether a particular carrier is entitled to any revenue recovery will be a question of fact in each case.

It was refreshing that Frontier -- apparently alone among all the ILECs -- recognized that ICC revenues are going away, and need not necessarily be replaced. Under Frontier's plan, ICC revenues of non-rural carriers would be moved to an "Intercarrier Compensation Transitional Replacement" mechanism, phased-down and

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[130] Verizon Comments, p. 28.

[131] NASUCA Comments, pp. 11-12. A state's recourse to the State Inducement Fund would be premised on the state having its own universal service fund to support high-cost areas within its borders. *Id*., p. 16.

eliminated over a five-year period.[132] ICC revenues of rural carriers would be moved to a "Carrier of Last Resort Network Support" fund. Although the fund would be reduced over the transition period, this replacement funding would not be totally eliminated for rural carriers.[133] In this regard, Frontier's plan is similar to NASUCA's five-year phase down of ICC rates, and deserves serious consideration by the Commission.

The record in this proceeding amply supports any Commission decision to reduce access rates, and to allow individual carriers to increase other revenues only upon a showing of need for additional revenues. The Commission should not adopt any proposal to automatically replace any revenues lost as a result of reduction of ICC rates.

C. The Commission Must Consider the Net Impact of Declining Access Rates on Local Exchange Carriers.

Most comments filed by local exchange carriers have focused on the fact that access rates charged by them will be declining under virtually all proposals, followed by their requests for automatic recovery of the lost revenue. However, it must be recognized that a reduction in existing access rates will not result in a corresponding reduction in revenue, for several reasons. First, as pointed out by NASUCA and others in initial comments, minutes of use are declining, which will result in a continuing reduction in revenue absent any change in access rates.[134] Second, as pointed out by the Ohio PUC, price cap carriers are likely to enjoy a net reduction of existing costs based on reduced

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[132] Frontier Comments, App. pp. 16-17.

[133] *Id.*, pp. 17-19.

[134] NASUCA Comments, p. 13.

access charges paid to terminate their traffic on networks of non-price cap LECs.[135] Third, since many LECs now have long distance affiliates, reductions in access charges paid by the IXC may actually result in net cost reductions for the carrier. Once again, all claims for replacement of lost revenue must be based on a factual showing by each carrier, not on unfounded assumptions.

D. Current Returns of Incumbent Price-Cap Carriers

As noted above, prior court decisions require that Commission orders be measured by the end results, and not by one particular factor. To that end it is instructive to review the current earnings of the carriers. Chart 1 and Table 1 below summarize the profits earned by the large holding companies from 1996 through 2004.[136]

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[135] PUCOh Comments, p. 24.

[136] The data and charts found in Tables 1 and 2 and Charts 1 through 3 are based on information reported in the ARMIS 43-01 reports. These data are displayed in Attachment A hereto.

Chart1

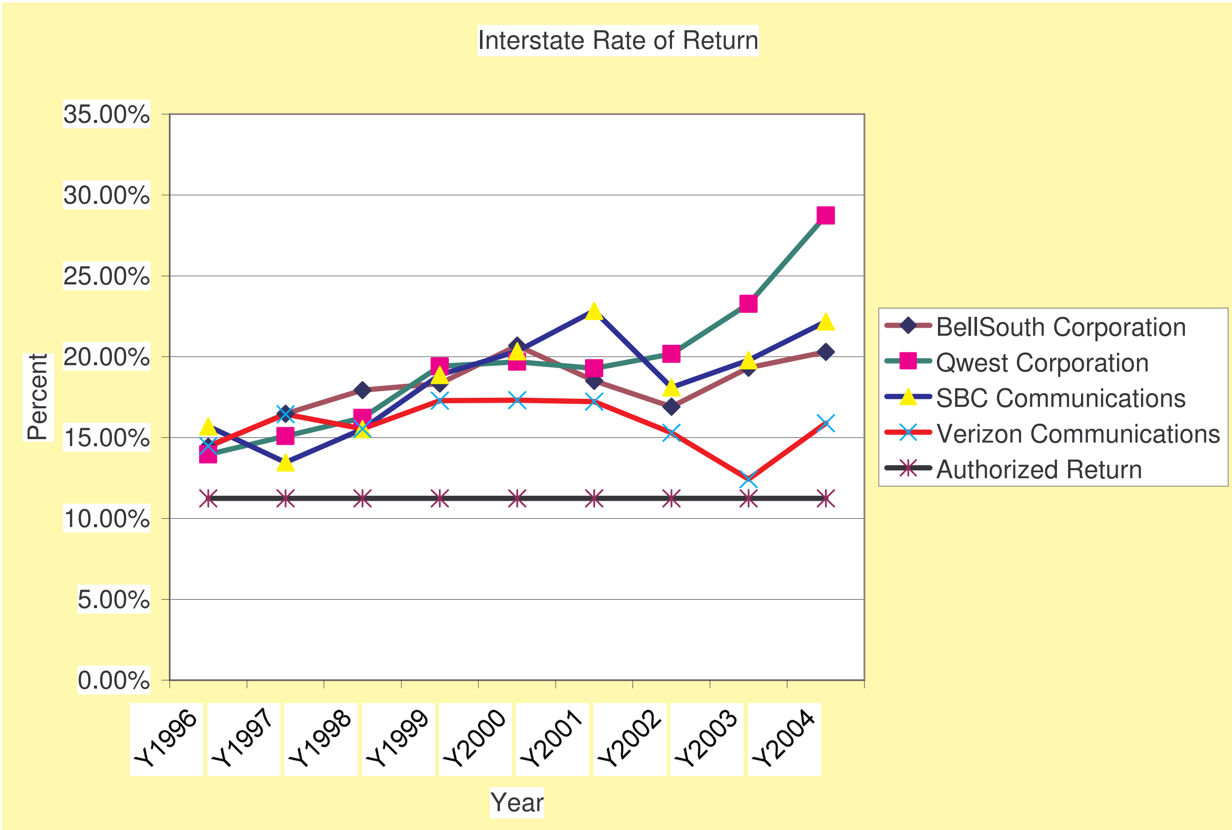
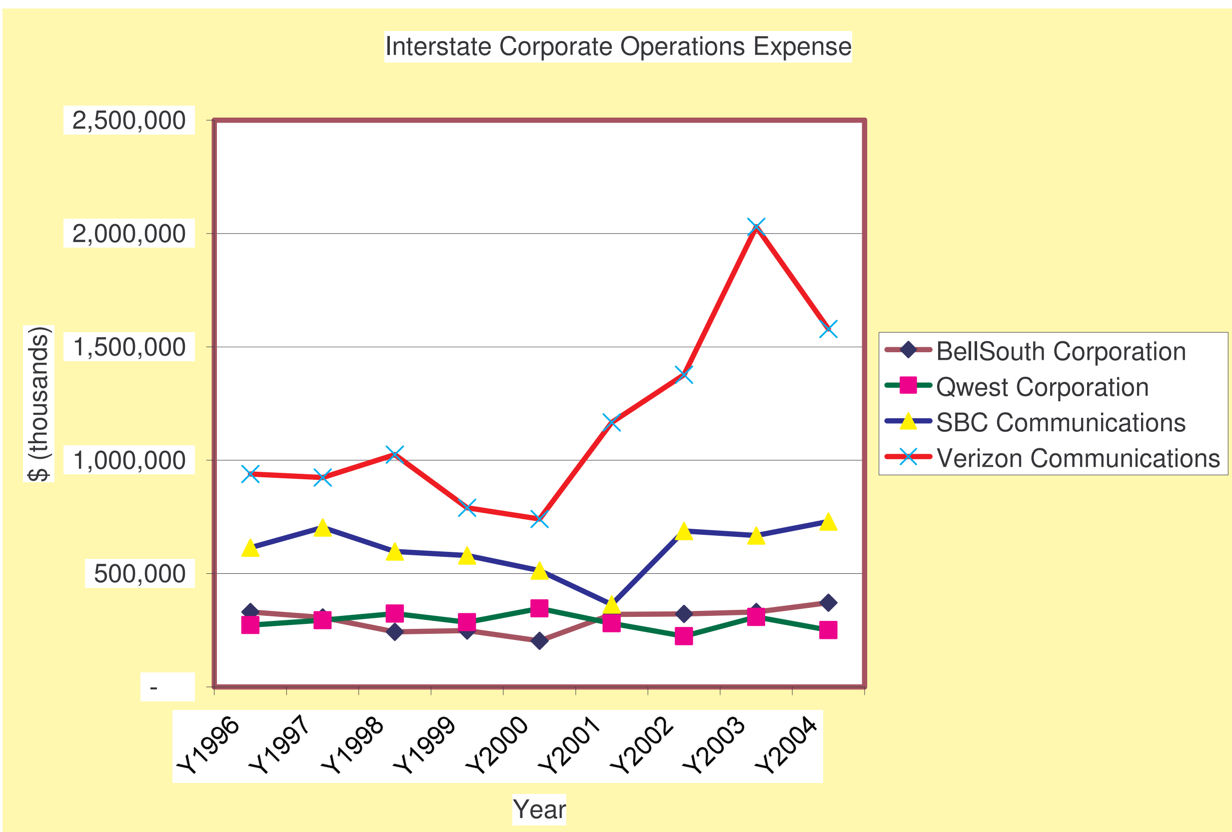


Table 1: Reported interstate returns by holding company 1996-2004									
BellSouth	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	14.43%	16.48%	17.93%	18.34%	20.69%	18.51%	16.91%	19.32%	20.30%
Qwest	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	13.96%	15.09%	16.22%	19.41%	19.69%	19.28%	20.18%	23.27%	28.72%
SBC	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	15.71%	13.47%	15.53%	18.88%	20.34%	22.84%	18.11%	19.79%	22.17%
Verizon	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	14.47%	16.45%	15.53%	17.28%	17.31%	17.22%	15.29%	12.44%	15.89%

The profits shown on Chart 1 and Table 1 are all well above the 11.25% authorized return on capital. For 2004, the reported profits are between 15.89% and 28.72%. Moreover, reported profits have generally been increasing over time.

Verizon is the only holding company whose profits appear to have declined in recent years. However, this decline is directly related to increases in corporate operations expenses. As shown on Chart 2, Verizon's interstate corporate operations expenses increased from $741 million in 2000 to $2 billion in 2003 and then declined to $1.6 billion in 2004.

Chart 2



These extraordinary increases in corporate operations expenses are unusual. In traditional rate cases to determine just and reasonable rates, regulatory commissions would make pro forma adjustments to these reported costs so that the expenses would reflect the normal operations of the carrier. With regard to corporate operations expenses, a pro forma adjustment could require the carrier to decrease this expense to a level representative of a normal year. A hypothetical example of such an adjustment would be to determine that 2000 is a normal year and then adjust corporate operations expenses to normal levels.

NASUCA is not specifically advocating such an adjustment here. Rather NASUCA is providing a hypothetical example of how to investigate unusual changes in carrier expenses. The correct adjustment can only be made after the Commission investigates the data provided by the carriers. The results of this hypothetical adjustment to corporate operations expense are shown for illustrative purposes in Chart 3 and Table 2 below. The adjustment increases Verizon's 2003 return from 12.44% to 21.85%, and its 2004 return from 15.89% to 22.63%. The adjustment also increases the return for BellSouth and SBC, and decreases the overall return of Qwest.

Chart 3

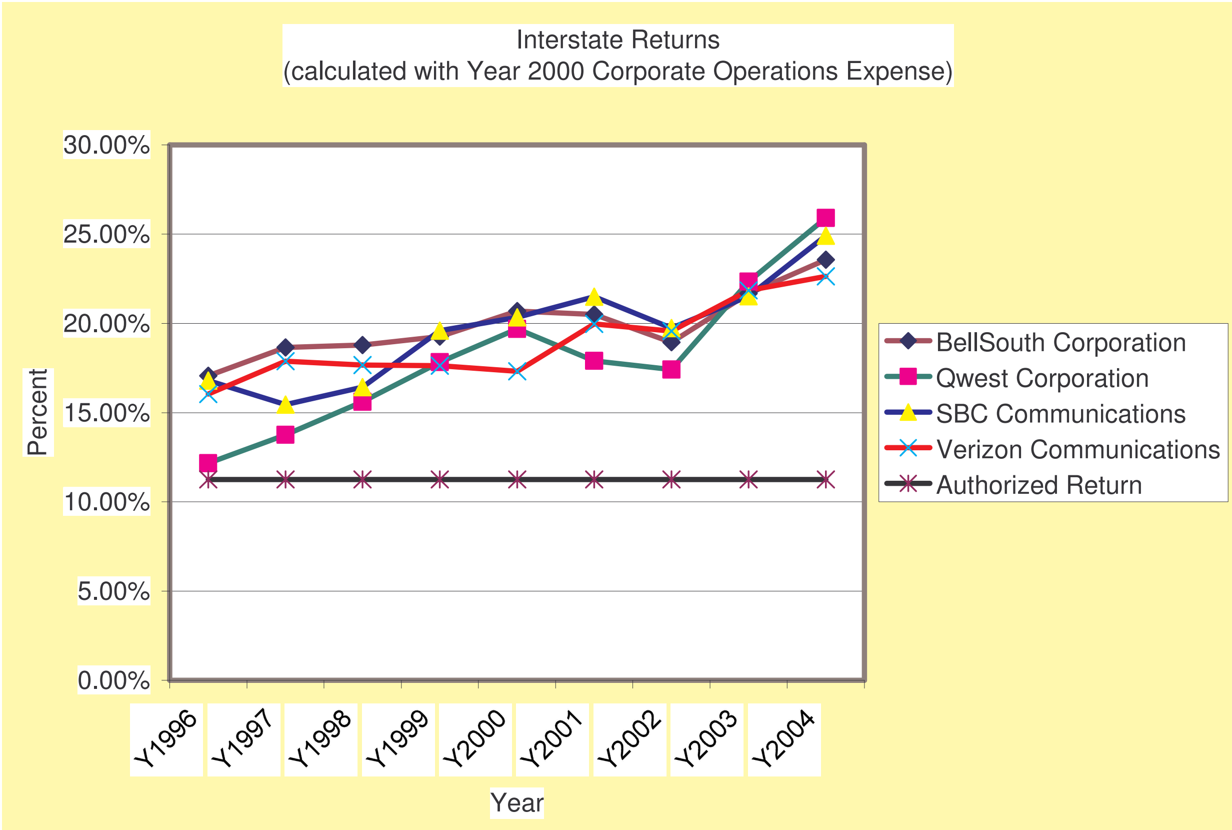


Table 2: Interstate returns by holding company, reported and adjusted for normal corporate operations expenses									
BellSouth	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	14.43%	16.48%	17.93%	18.34%	20.69%	18.51%	16.91%	19.32%	20.30%
Adjusted Return	17.06%	18.65%	18.78%	19.26%	20.69%	20.49%	18.94%	21.67%	23.57%
Qwest	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	13.96%	15.09%	16.22%	19.41%	19.69%	19.28%	20.18%	23.27%	28.72%
Adjusted Return	12.16%	13.76%	15.61%	17.83%	19.69%	17.90%	17.41%	22.33%	25.90%
SBC	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	15.71%	13.47%	15.53%	18.88%	20.34%	22.84%	18.11%	19.79%	22.17%
Adjusted Return	16.80%	15.44%	16.43%	19.59%	20.34%	21.49%	19.74%	21.51%	24.91%
Verizon	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
Reported Return	14.47%	16.45%	15.53%	17.28%	17.31%	17.22%	15.29%	12.44%	15.89%
Adjusted Return	16.04%	17.88%	17.67%	17.63%	17.31%	19.97%	19.57%	21.85%	22.63%

This summary of holding company profits indicates that these companies are extremely profitable and that their profits are well above the authorized rate of return.[137] Even if the carrier's overall revenue decreases due to the fact that access rate reductions are not matched by revenue neutral rate increases, there is very little cause for concern that carriers would be placed in a financially distressed position. The ICC proposals that provide for revenue neutral rate increases are unwarranted and should not be approved.

E. The Authorized Return for Rate of Return Carriers

The authorized return for rate of return carriers is also 11.25%. The Commission found that this return was reasonable in 1990.[138] In 2001, the Commission terminated its investigation of the appropriate level of return.[139] The need for an investigation into the current appropriate rate of return is obvious. The extended time period since the previous authorization means that many of the assumptions used to determine the previous return have changed significantly. For example, the long term debt rate examined by the Commission when it authorized the 11.25% return was 8.4%.[140] The current long-term interest rate is only 4.46%.[141] Maintaining an antiquated overall rate of return of 11.25%

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[137] It must be remembered that the reported returns are overall returns, including returns on both the equity and debt components of each company's capital structure. Given that debt costs have declined substantially in recent years, it is obvious that the return on equity for each of the RBOC's is far in excess of the overall return reported here. For example, the simple average of the adjusted returns for 2004 shown on Chart 3 is 24.25%. Assuming a 60% equity, 40% debt capital structure, and a very conservative embedded debt cost rate of 8%, the resulting return on equity would be 35.08%.

[138] *In the Matter of Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, 5 FCC Rcd 7507, 7509 (1990) ("*Rate of Return Order*") (¶13).

[139] *MAG Order,* 16 FCC Rcd at 19622 (¶15).

[140] *Rate of Return Order*, 5 FCC Rcd at 7527 (¶170).

[141] Federal Reserve Statistical Release, H.15, Selected Interest Rates, Release Date: July 13, 2005, http://www.federalreserve.gov/releases/h15/update

in the context of dramatically lower capital costs means that rate of return carriers are actually achieving a bloated and unreasonable return on the equity portion of their capital structures.

In the instant proceeding, several groups representing rate of return carriers have requested automatic recovery of all revenues lost (or potentially lost) as a result of reform of intercarrier compensation.[142] The only basis for automatic recovery of lost revenue is the assumption that the current revenue stream is just and reasonable. However, it is not possible for the current revenue stream to be considered just and reasonable unless and until the Commission also investigates and determines that the current return is just and reasonable. Without such a finding, there is no support for recovery -- automatic or not -- of any lost revenues by rate of return carriers.

VII. OTHER ISSUES

A. Proper Labeling of Intercarrier Traffic

Proponents of bill-and-keep have promoted their plan as a remedy to the problem of "phantom" (mislabeled or unlabelled) intercarrier traffic. They argue that because under bill-and-keep the cost of exchanging traffic is zero, there would be no incentives to produce phantom traffic.[143] This is akin to arguing that the solution to theft is the repeal of laws against stealing. Of course, no commenters came out in favor of phantom traffic or alleged they had a right not to label (or a right to mislabel) their traffic. A large

[142] See NTCA Comments, pp. 26-27; Rural Alliance Comments, pp. 14; 73-74.

[143] ICF Comments, p. 13-16; CTIA Comments, pp. 17-18.

number of commenters, including NASUCA, called for the Commission to address the issue of phantom traffic by enforcing existing requirements to properly label traffic.[144]

Such enforcement will continue to be necessary since in this world of temptation, carriers are likely to continue to devise ways to avoid their responsibilities. This should be discouraged by carrier education and the imposition of swift, certain and effective sanctions.

B. Implicit Subsidies and the Recovery of Traffic Sensitive Costs

The FNPRM requests comments on the traffic-sensitive nature of the switch, and questions whether switches should continue to be considered traffic sensitive.[145] The cost characteristics of the switch are important for two reasons. First, the Commission has a long history of finding that traffic-sensitive costs should be recovered on a traffic-sensitive basis, i.e., per minute of use, and that non-traffic-sensitive costs should be recovered on a non-traffic-sensitive basis, i.e., per line.[146] These findings were based on the Commission's understanding of efficient cost recovery. The implications of a change in the classification of switching costs are important. If the entire switch is considered non-traffic-sensitive, recovery of switch costs through higher SLCs might be appropriate. However, if the switch is traffic-sensitive, recovery of switching should continue to be based on traffic-sensitive rate elements, such as the current per-minute ICC charges.

[144] Alexicon Comments, p. 4; Beehive Comments, pp. 3-4; CaSLECs Comments, pp. 9-10; CenturyTel Comments, pp. 9-10; Rural Alliance Comments, pp. 107-111; TDS Comments, pp. 10-12.

[145] FNPRM, ¶ 67-68.

[146] See for example, *MAG Order*, 16 FCC Rcd at 19263 (¶17).

Second, the Act expresses a preference for the removal of implicit support in interstate rates: support funded by an interstate mechanism "should be explicit." [147] If the switch is traffic-sensitive, then recovery of switch costs through increases in the non-traffic-sensitive SLC would shift costs from high-usage customers to low-usage customers. This would create a new implicit support mechanism, and would be improper.

The comments of BellSouth and NTCA provide detailed discussions of switching cost characteristics. These parties agree that both the older circuit switches and the new packet switches are traffic-sensitive. BellSouth explains that only the line termination ports of the circuit switches are non-traffic-sensitive.[148] The other parts of the switch are traffic-sensitive. BellSouth notes that major switch components, the line and trunk modules, are traffic-sensitive because the line module investment reflects line concentration ratios and trunks are engineered based on anticipated traffic loads.[149] BellSouth also asserts that switch vendors have increased the processor's capacity so that switch can process calls quicker. In sum, BellSouth contends that between 66 to 72 percent of its switch investment is traffic-sensitive, and 28 to 34 percent of its switch investment is non-traffic-sensitive.[150]

These percentages are important because they match the percentage of the switch investment that is currently recovered through the SLC. That is, the FCC has already directed the price-cap carriers to move the costs associated with the line termination into

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[147] 47 U.S.C. §254(e).

[148] BellSouth Comments, p. 24.

[149] *Id.*, p. 23.

[150] *Id.*, p. 24.

the common line basket, and has allowed recovery of those costs through increases in the SLC.[151] With regard to rate of return carriers, the FCC established a safe harbor of 30 percent for the amount of switch investment that could be moved into the common line basket and allowed recovery of that transfer through increases in the SLC and the interstate common line support ("ICLS") mechanism.[152]

The NTCA comments and the white paper prepared by Thompson and De Witte in support of the NTCA's comments not only agree with the BellSouth's comments, but also show that packet switches are traffic-sensitive. Thompson and De Witte explain that circuit switch investment is sensitive to increases in holding time for individual calls and to increases in call volume.[153] Thompson and De Witte's explanation discusses the fact that switches are engineered to meet a particular Grade of Service ("GOS"). They provide a thorough discussion of the relationship between the GOS, traffic parameters such as the number of calls and call duration, and switch cost.[154] That discussion clearly demonstrates that circuit switches are traffic-sensitive.

With regard to packet switches, Thompson and De Witte contend that processing power is measured in terms of packets per second. They argue that as the number of calls increases, the processing power and the number of interfaces built into a packet switch

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[151] *Access Charge Reform Order*, 12 FCC Rcd at 16035-16037 (¶¶125-129); *CALLS Order*, 15 FCC Rcd at 12990-12994 (¶¶ 75-83).

[152] *MAG Order*, 16 FCC Rcd at 19621; 19633; 19654-19655 (¶¶15; 40; 93-94).

[153] Larry Thompson and John De Witte, *Traffic Sensitivity of Telephone Switching Equipment: Technology White Paper*, May 2005, page 4.

[154] *Id.*, p. 8-18.

must also increase.[155] Therefore, a packet switch is traffic-sensitive, i.e., its costs increase with the volume of traffic it handles.

The BellSouth and NTCA comments support NASUCA's position that it is proper to continue to recover the cost of switches on a traffic-sensitive basis.[156] These comments also support Dr. Gabel's contention that "for both packet and circuit switching, the amount of equipment installed in an office is a function of busy hour traffic."[157] The BellSouth and NTCA conclusions that switches are traffic-sensitive ultimately support NASUCA's position that the SLC should not be increased. The SLC is already high enough to recover the portion of the switch that is conceded to be non-traffic-sensitive (approximately 30 percent). Any additional recovery of switching costs through the SLC would amount to improper, implicit support.

VIII. UNIVERSAL SERVICE

A. ICC Reform Can Be Accomplished Without Major Changes to the Universal Service Support Mechanisms.

The present structure of the USF is generous in its allowances to ensure that rural rates are affordable and reasonably comparable to urban rates. Given that the universal service mechanism is not designed as a revenue recovery mechanism, but as a means to support local rates, adjustments to the universal service fund as a result of restructuring ICC should not be automatic, and need not be major or structural.[158] Nevertheless,

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155 *Id*., p. 21.

156 NASUCA Comments, p. 25.

157 *Id.*, Att. 4, Affidavit of David J. Gabel ¶ 31.

158 The guarantee of revenue neutrality drives the universal service proposals of most carriers.

several plans present revenue replacement schemes in the guise of "universal service." This over-reaching on universal service issues is a major flaw inherent in these plans.

B. Many of the Universal Service Proposals Have Little Relevance to Intercarrier Compensation Reform.

KMC correctly notes that many of the plans -- like ICF, CBICC and various rural carriers (including the EPG members of the Rural Alliance) -- include so-called universal service provisions that are really revenue replacement mechanisms and are explicitly not portable among carriers.[159] These proposals are unreasonable on their face.[160] On the other hand, KMC also would have support based on the forward-looking cost of providing service using efficient technology.[161] CTIA would have the Commission adopt a single, unified high-cost universal service support system.[162] Like many other subjects contained in the various comments, these proposals have no immediate relevance to the solution of the ICC problem.

This is true for plans that require adoption of a connection-based mechanism.[163] KMC states that although "universal service needs a better funding mechanism, moving

[159] KMC Comments, p. 32. See also Pac-West Comments, p. 7.

[160] As the Commission is aware, NASUCA's universal service proposals have long included substantial qualifications for receipt of federal universal service funding. These qualifications are intended to apply across the board to all carriers. Only in the circumstance where per-line support is extremely high do NASUCA's proposals effectively limit portability, by allowing only one eligible telecommunications carrier ("ETC") in a specific territory. NASUCA's proposal that support be limited to a single connection per household allows the household to determine which single carrier (of however many are available to that household) will receive the funding.

[161] *Id.*; see also Leap Comments, p. 14.

[162] CTIA Comments, pp. 38-39; see also Leap Comments, p. 15.

[163] See Frontier Comments, pp. 12-15; Mpower Comments, p. 14; USTA Comments, pp. 14-15; ICF Comments, pp. 31-33.

from a revenue-based system to a connection-based or telephone-number based system will not accomplish that goal."[164] As set forth previously in other dockets before the Commission, NASUCA agrees. Further, although the base of universal service contributions needs to be broadened by including the revenues of all interstate telecommunications and telecommunications services, this issue is not directly tied to resolution of ICC issues.

SBC spends much of its comments complaining about the universal service system.[165] SBC's main complaint is reserved for the fact that universal service responsibility is placed on wireline DSL and not on cable modem service. NASUCA agrees -- and agrees with T-Mobile and others that the current revenue-based mechanism should be expanded.[166] But such fundamental changes have little necessary relation to the key ICC issues. It is certainly not a ground to accept any one of the plans in its entirety, as SBC urges the Commission to do with the ICF plan.[167] As discussed above, neither is altering the contribution mechanism[168] a necessary part of ICC reform.

Some of the comments pour out generalities about universal service that have little to do with intercarrier compensation reform. For example, NTCA argues that any new universal service support mechanism must include incentives to ensure broadband

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[164] KMC Comments, p. 44. KMC goes on to note (correctly) that "the challenge for the Commission is to control universal service expenditures and expand the base of contributors to ensure to the extent practicable that no one group of service providers bears an inequitable USF support burden." *Id*. See also ANPA Comments, pp. 10-11.

[165] SBC Comments, pp. 24-31.

[166] T-Mobile Comments, p. 35; Leap Comments, p. 15; ANPA Comments, p. 10; Frontier Comments, p. 13.

[167] SBC Comments, pp. 29-30.

[168] *Id*., p. 30.; see also Time Warner Comments, p. 6.

deployment.[169] Needless to say, broadband is not yet a supported service. Proposals to vindicate long-standing universal service issues are simply red herrings in the ICC debate.

In the context of ICC reform, universal service should serve as a backstop for carriers that can show a need for additional revenue to ensure reasonably comparable, affordable rates in the aftermath of ICC reform -- no more, no less. NASUCA's proposal contains the smallest adjustment to existing USF support mechanisms of any of the proposals -- one of its important benefits[170] -- and we do not believe that supporting broadband service is a necessary component of the proposal. The issue of support for broadband deployment deserves full consideration -- *in another proceeding* -- but has little to do with intercarrier compensation. This proceeding involving ICC is clearly neither the place nor the time to make major reforms to the USF.

NASUCA must respond, however, to some of the more egregiously incorrect industry arguments about universal service. For example, T-Mobile implies that there is something wrong with a system in which, in 2004, wireless carriers paid almost 27 per cent of all universal service contributions, but received only seven per cent of all universal service support.[171] Initially, it is necessary to note that wireless carriers' **customers** made those contributions.[172] But T-Mobile's complaint is actually with the

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[169] NTCA Comments, pp. 34-36.

[170] To that extent, NASUCA's proposal reduces the need for a pre-decision on the "future of the existing universal service support mechanisms for rate-of-return carriers" that JSI correctly notes is crucial for many of the proposals. JSI Comments, p. 3.

[171] T-Mobile Comments, p. 31; see also ANPA Comments, p.10.

[172] T-Mobile and most other carriers assess a separate line item surcharge on their customers to fully recover the federal USF assessment placed on those carriers.

fundamental nature of the federal universal service system, which assesses interstate services, but is intended to benefit local service.[173] Indeed, even if wireless carriers as a class received precisely the same amount of support that their customers contributed, it is doubtful -- indeed, factually impossible -- for each carrier's customers to get back in support precisely the amount they contributed. In any event, T-Mobile's argument has already been considered and rejected. In the *Qwest II* decision, the 10th Circuit stated: "We agree with the FCC that the plain text of the statute merely imposes an obligation on the carriers to contribute to universal service funds; it does not impose a requirement of parity with respect to internal functioning and the distribution of funds between and among carriers."[174]

On the other hand, CTA argues that without any showing of need, carriers should be able unilaterally to increase their local rates up to a benchmark, which CTA identifies as the RBOC urban benchmark (including the SLC) of $21.07.[175] Along with the other proposals that automatically increase end-user rates (including the SLC) to recover lost ICC revenues, the CTA proposal simply lacks justification, other than the carriers' desire for additional revenues.

Finally, JSI correctly notes that the current USF mechanisms are in a state of flux, and "urges the Commission to consider recommendations made by the Joint Board with

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[173] In the same vein as T-Mobile's complaint, IXCs contributed 37% of total USF funds in 2004, but received no high-cost support. *Trends in Telephone Service*, WCB, Industry Analysis and Technology Division (June 2005), Tables 19.2 and 19.17. Similarly, payphones and paging services contribute to the USF, but receive no support from the fund. It has never been a requirement that payers into the federal universal service system receive a concomitant amount of universal service support, and carriers' suggestions to the contrary are merely self-serving.

[174] *Qwest v. FCC*, 398 F.3d 1222, 1233 (10th Cir. 2005).

[175] CTA Comments, p. 35.

regard to the existing USF mechanism before finalizing any changes to the existing intercarrier compensation regimes."[176] NASUCA does not disagree, but would point out that NASUCA's proposal, among all the others, requires the least substantial changes to the existing USF. As NASUCA has stated, its transitional plan is recommended in part because it requires the least changes to the existing structure of ICC and universal service.

IX. RESPONSE TO THE ICC PROPOSALS OF OTHER PARTIES

In its initial comments, NASUCA responded to several ICC reform proposals which had been presented by other parties such as ICF, ARIC, EPG, Home/PBT, and CBICC. Because the NARUC Task Force on Intercarrier Compensation ("NTFIC") plan was still in flux, NASUCA reserved the right to comment upon whatever final version was submitted to the Commission for consideration. In addition, several parties submitted formal plans for the first time in initial comments in this proceeding. NASUCA will respond here to the proposals put forward by NTFIC, BellSouth and Qwest.

A. The NARUC Task Force Proposal Is Flawed and Cannot Be Adopted as a Whole.

1. Introduction

The Commission received two submissions from NARUC in this proceeding: comments filed on behalf of NARUC as a whole ("consensus comments"), and the most

[176] JSI Comments, pp. 3-4.

current version of a plan developed by NTFIC.[177] As discussed elsewhere in these reply comments, NARUC's consensus comments focus primarily on establishing that the Commission cannot -- and should not -- preempt state commissions on intrastate ICC. NASUCA's strongly agrees with NARUC on this point.[178]

NARUC has also adopted a set of ICC policy principles, which were filed in this docket on May 5, 2004.[179] NASUCA has few disagreements with those principles. Indeed, NASUCA is gratified that, in its discussion of the application of the NARUC principles to the proposals described in the FNPRM, NARUC notes that "*of the proposals listed in the NPRM*, NASUCA's plan … comes closest to the listed NARUC principles…."[180] NASUCA agrees with NARUC that the ICF plan, the Western Wireless proposal and the CTIA principles all violate the NARUC principles "because none includes a substantial State role and all *mandate* bill-and-keep."[181] NASUCA also agrees with NARUC that other plans -- the EPG plan, the ARIC plan,[182] the CBICC plan, and the Home/PBT plan -- are problematic because "each requires some preemption of intrastate access rates."[183]

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[177] As noted in NASUCA's initial comments and discussed below, the plan presented by the NARUC Task Force is not the official position of NARUC.

[178] See Section IV.A. above.

[179] See NARUC Comments, p. 2.

[180] *Id.,* p. 4 (emphasis in original).

[181] *Id.*, p. 3 (emphasis in original). The shortcomings of the ICF plan were discussed at length at pages 46-48 of NASUCA's Initial Comments.

[182] As previously noted, EPG and ARIC have combined into the Rural Alliance.

[183] *Id.*, pp. 3-4.

NARUC has also engaged many state commission representatives and a broad spectrum of the industry in the NTFIC. NASUCA has participated in many of the meetings and the conference calls held by the NTFIC, and applauds NTFIC for its attempts to build a consensus plan on these contentious issues.

The NTFIC has developed a proposal that has gone through a number of iterations. The most recent version of the proposal -- designated as "Version 7" -- was part of a May 18, 2005, *Ex Parte*, and is mentioned in NARUC's comments.[184] As NARUC's comments describe it,

> The Task Force proposal draws elements from several plans proposed by industry groups, but also proposes some new ideas. While the Task Force discussions of this proposal continue, it is important to point out that NARUC has not yet fully endorsed it.[185]

The lack of specific support for the specific proposals contained in Version 7 is evident from the comments of individual state commissions.[186]

Unfortunately, in its attempts to achieve consensus,[187] the NTFIC proposal submitted to the Commission contains some provisions that are objectionable, and much that is unnecessary. Just as NASUCA cautioned the Commission against adopting one of the proposals as a whole in the mere interest of uniformity,[188] neither should the NARUC

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184 *Id.*, NARUC Comments, p. 2, n.3. NTFIC's draft proposal (Appendix C to the May 18, 2005, *Ex Parte*) will be cited here as "Version 7."

185 *Id.*

186 InURC Comments, pp. 2-3; IUB Comments, pp. 2-4; MePUC/VtPSB Comments, pp. 1-2; MtPSC Comments, p. 2; NebPSC Comments, p. 11; NJBPU Comments, pp. 6-7; NDPSC Comments, p. 3; MoPSC Comments, pp. 3-4; PUCOh Comments, pp. 11-12; PUCOr Comments, p. 2; RCA Comments, p. 8; SDPUC Comments, pp. 2-12; WisPSC Comments, p. 2; WyPSC Comments, p. 1. Other state commenters, such as NYDPS and PUCTx, do not mention the NARUC principles or the NTFIC proposal.

187 See NARUC Comments, p. at 2, n.3.

188 NASUCA Comments, pp. 45-46.

proposal -- in whatever version -- be adopted merely because it purports to be a consensus. The consensus claimed by NTFIC is illusory at best.

2. *The Reasonable Substance of NARUC Version 7*

There are, as noted above, many key aspects of Version 7 with which NASUCA strongly agrees. One of the key points of Version 7 is its insistence on voluntary state participation. NARUC's pricing proposals attempt to reduce the disparity among ICC rates, but also allow states to totally opt out of the process. This is consistent with the statutory limitations on Commission action discussed in section IV above.

NASUCA also agrees with other aspects of Version 7:

Applicability to all traffic -- NASUCA very strongly agrees with the NTFIC that VoIP traffic that uses the PSTN should pay for that use, just like all other traffic.

Originating traffic -- NTFIC correctly recognizes that carriers that use the networks of other carriers impose costs on those carriers, and that the cost of ICC cannot be zero. Without addressing Version 7's two alternatives specifically, NASUCA disagrees with the "equal access costs" rationale for the first alternative. Otherwise, neither alternative is clearly superior to the other.

Terminating traffic -- NASUCA agrees that the terminating rates proposed by Version 7 could apply to smaller rural carriers.[189] These rates correctly recognize scale and scope economies of larger central offices. Yet these rates should not be available for non-rural carriers, whose substantially greater overall size gives them access to economies of scale and scope not available to rural carriers. Non-rural carriers should be

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[189] Version 7, p. 4. As noted in NASUCA's recent comments to the Joint Board in the rural support referral, there are many different sizes of rural carriers. Many larger carriers classified as "rural" under the Act enjoy the same economies of scale and scope as non-rural carriers.

transitioned to a uniform rate as proposed by NASUCA.[190] It is important to note that to the extent the NARUC gradations minimize the impact on RLECs, this reduces pressure to collect these revenues from end users and USF. (As discussed below, the use of end user charges and the USF as a means of revenue guarantee for LECs is a major flaw of the NTFIC proposal.)

State Role -- NASUCA agrees with NTFIC's proposals on State arbitration and State approval of voluntary agreements.[191] NASUCA also agrees with Version 7's provisions on out of balance restriction[192] and phantom traffic.[193]

Lifeline -- NASUCA agrees that Lifeline customers should be protected from the impacts of changes in the ICC regime.[194] NASUCA's plan does so by not automatically passing the impact of ICC revenue decreases on to end users, whether through local rate increases or increased SLCs. To the extent that Lifeline consumers see increased rates as a result of this restructuring, they should of course be insulated from the effects of such increases.

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[190] As to terminating transport, the problem with NTFIC's distance sensitive proposal is that in trying to resolve all of the concerns of the various parties, it ends up with a result that deviates from the central goal of ICC reform: elimination of disparity among ICC rates. It is already a given that adoption of any target rates will deviate from the actual costs of particular carriers. However, this deviation is typically justified by the benefits achieved: minimization of opportunities for rate arbitrage, mislabeling of traffic, etc. The Version 7 proposal, which has different rates for different sized wire centers and terminating transport rate adders for rural telcos that vary by distance, ensures that there will continue to be widely disparate rates. In fact, the end result of the NTFIC proposal is not that different from the original ARIC proposal in that every carrier will have a different weighted average termination rate.

[191] Version 7, pp. 4-5.

[192] *Id.*, p.5.

[193] *Id.*, p. 6.

[194] *Id.*, p. 10.

Transition Period -- Finally, although NASUCA believes that a five-year transition such as we proposed would be optimal, a four-year transition like that included in Version 7 would be feasible. The key would be defining when the four years begin.[195]

3. There are many unnecessary parts of Version 7.

In part because of its attempts to reach a broad consensus, the NTFIC proposal includes components that are important to various industry members, but are not vital or even necessary for the resolution of ICC issues. This particularly includes the ICF edge proposal, which Version 7 incorporates.[196]

Other basically unnecessary parts of Version 7 include otherwise-correct principles that are not key to ICC issues and are currently being considered in other fora. This would include universal service issues of technological neutrality and broadening the contribution base.[197] NASUCA supports these positions, but they need not be addressed as a part of an ICC solution.

Then there is Version 7's proposal to develop benchmark end user rates.[198] Although the original intent of these benchmark rates was apparently to make sure that all local customers are making a certain minimum contribution to support of their own local rates before they have recourse to federal universal service support, the NTFIC proposal has now transmogrified universal service into a vehicle to raise local rates. As should be obvious, and as stated many times before, the purpose of universal service is **not** to raise

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[195] It appears from Version 7 that the four year transition period would begin once the Joint Boards on Separations and Universal Service had reviewed the respective issues and the Commission had responded to their recommended decisions. Version 7, p. 6.

[196] Version 7, pp. 13-14.

[197] *Id.*, pp. 7-8.

[198] *Id.*, pp. 8-10.

local rates. As reiterated in NASUCA's proposal, intrastate ratemaking is the proper province of the states, and decisions on local rates should be left to the states. Federal policy cannot mandate local service rate increases.[199]

4. *Other portions of NARUC Version 7 are contrary to the public interest.*

NASUCA's primary objection is to Version 7's proposal to increase the SLC.[200] The NTFIC proposals -- like others that include automatic increases to the SLC -- fail to justify why lost ICC revenues should be recovered through the SLC, a non-bypassable charge that does not vary with the customer's usage of the network. The access charges that these proposals replace were, of course, based on usage of the network.

This approach takes out of the hands of state regulators the responsibility for local rates. Under the NTFIC plan, a carrier could raise the SLC up to $2 per year each year for four years, depending on the level of local rates. This means that a carrier with a $6.50 SLC now could end up with a $14.50 SLC at the end of the NTFIC transition period,[201] dependent only on the amount of lost ICC revenue.[202] NASUCA has previously addressed the ICF's unreasonable proposal to increase the SLC to $10.00 per

[199] The SDPUC recommends that the Commission and state commissions work together to establish benchmark rates. SDPUC Comments, p. 11. Of course, NASUCA, other consumer interests and the industry will want to participate in this effort, which need not take place in the context of ICC. While it may be appropriate to use rate benchmarks to determine if a particular carrier qualifies for universal service support, rate benchmarks should not be used as a means to automatically increase local rates.

[200] Version 7, pp. 8-9.

[201] An increase in the monthly SLC of $2 per year times four years equals $8.00 total SLC increase. Adding this increase to the existing SLC of $6.50 equals a SLC of $14.50 at the end of the four year transition period.

[202] Version 7 recommends Joint Board referrals for these issues. Version 7, p. 15. NASUCA supports this in principle, but it appears that the main purpose of the Joint Board referrals under the NTFIC proposal is to eliminate the current interstate/intrastate jurisdictional distinctions. NASUCA cannot support this proposal.

month.[203] NTFIC's proposal imposes even higher SLCs on end-users – a result contrary to sound public policy.

The increases to the SLC are part of the NTFIC's "Access Charge Transition Fund" ("ACTF"), which is the predecessor to the USF "State Allocation Mechanism" and the permanent rate benchmark.[204] It appears that the primary purpose of the ACTF is to maintain LEC revenues. As discussed at length here and in NASUCA's initial comments, this is not a proper concern of ICC reform. The functioning of the ACTF, with its "transitional rate benchmark," "Local Subscriber Rate Effort," and "Minimum Rate Effort Standard" is a very complicated way to accomplish this revenue guarantee.[205] The complications cannot mask the fundamental unfairness of the proposals. Again, these proposed federal mechanisms appears to remove from state commissions the responsibility for local rates. NASUCA's proposal retains state jurisdiction, but also retains state responsibility. NASUCA believes that responsibility for decisions produces better and more rational decisions.

As noted above, major parts of the universal service portions of Version 7 -- with which NASUCA largely agrees -- are not really germane to ICC, and should be addressed in their proper dockets. On the other hand, other universal service parts of Version 7 are not only irrelevant to a discussion of ICC, they are not in the public interest.

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203 NASUCA Initial Comments, pp. 29-31.

204 Version 7, pp. 8-10; 11-12.

205 Complicated, but apparently not complicated enough: The LSRE does not include any consideration of local calling scope, a crucial issue in rural areas. See MITS Comments, pp. at 7-8; USTA Comments, p. 42, n. 64.

One of these is the proposal that state USFs "piggyback" on top of the federal USF.[206] This violates the express terms of 47 U.S.C. 254(f), which allows intrastate USFs that do not burden the federal USF. The NTFIC proposal makes state universal service funds part and parcel of the federal fund, and essentially absolves states of responsibility for their own universal service funds.[207]

Another unnecessary section calls for the elimination of the differences between rural and non-rural carriers for the purpose of universal service support.[208] This proposal is inappropriate, as is the related proposal to make ICC charges dependent only on the size of the wire center rather than also considering the size of the serving ILEC. The Commission has been properly cautious about unifying the rural and non-rural support mechanisms. While it may be appropriate to unify support mechanisms for non-rural carriers and some of the larger rural carriers,[209] the Commission has repeatedly cited the lack of economies of scale and scope, and the great variability among smaller carriers as reasons for maintaining separate support mechanisms for these smaller carriers.[210] Those facts have not changed. In addition, NTFIC makes no attempt to operationalize these proposals or quantify their ultimate cost, two factors which should be explored before undertaking a radical restructuring of federal universal service.

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[206] Version 7, p. 12.

[207] In contrast, NASUCA's State Inducement Fund proposal requires states to implement their own universal service funds before having recourse to additional federal support.

[208] *Id.*, p.7.

[209] Much of NASUCA's effort in this area has been to make support for larger "rural" carriers more akin to that provided non-rural carriers. To the contrary, the NTFIC proposal would make non-rural carriers' support more like that allowed for the smallest of rural carriers.

[210] See for example, *MAG Order*, 16 FCC Rcd at 19628-19629 (¶28).

Another unnecessary and wrong idea is NTFIC's proposal to move to a connections-based universal service contribution mechanism.[211] Quite apart from the fundamental violation of funding responsibility for the federal USF (see 47 U.S.C. 254(d)), is the fact that, as shown in earlier NASUCA comments, a connection-based mechanism is no better able to withstand massive increases in the federal USF -- such as those necessitated under many of the ICC proposals -- than the current revenue-based mechanism.[212]

Also unnecessary to ICC is the adoption of a permanent rate benchmark of 125% of the national urban rate.[213] The current monthly national urban rate is $24.31. Version 7 provides no explanation of why a rate of $32.82 (135% of national urban average) is not reasonably comparable, while a rate of $30.39 (125% of national urban average) is reasonably comparable. In short, the 125% benchmark is just as arbitrary as the previous 135% benchmark. Further, NTFIC has produced no quantification of the impact of the lower benchmark on the federal High-Cost Fund. The 125% rate comparability benchmark combined with NTFIC's proposals to support all high-cost wire centers and establish the ACTF would undoubtedly explode the already overburdened high-cost fund. NTFIC's expansive but unquantified proposals should be compared to the targeted and limited USF funding permitted under NASUCA's plan.

The final problematic piece of the NTFIC plan is the so-called "State Allocation Mechanism," which allows state commission discretion on how to distribute federal USF

[211] Version 7, p. 8; see also ICF Comments, p. 31; Comporium Comments, p. 11.

[212] Docket No. 96-45, *et al*, NASUCA Reply Comments (May 16, 2003).

[213] Version 7, pp. 11-12. The NTFIC proposal shares this proposal with the Rural Alliance. While NASUCA agrees that the rate comparability benchmark process should be extended to rural carriers, there is no basis for adopting a 125% rate comparability benchmark proposed by NTFIC Version 7.

monies.[214] This is apparently a key inducement for states under the NTFIC plan. If a state participates in the plan, then it determines how the USF is allocated within its borders. The NTFIC plan would allow a state's USF allotment, based on the rates and costs of individual LECs and CETCs, to be transferred to other LECs within the state. Quite apart from the wisdom of this delegation,[215] the price of obtaining this advantage is too high: state abdication of responsibility over intrastate ICC and local rates.[216]

In summary, while there are many good ideas contained in the NTFIC proposal, the defects and unanswered questions contained in the proposal outweigh any potential benefits. As a result, the NTFIC proposal should not be adopted by the Commission. NASUCA continues to believe that its evolutionary approach is superior to any of the other proposals -- such as NTFIC Version7 -- that require radical restructuring of existing jurisdictional and industry relationships.

B. Qwest's ICC Proposal

Qwest calls its ICC proposal "bill-and-keep at the edge." As the name implies, there would be no exchange of ICC charges between interconnecting carriers. Carriers which require transport services to carry traffic to an "edge," would have to procure such services at market-based rates.[217] All revenues lost as a result of elimination of ICC rates would be recovered by each carrier from an uncapped SLC imposed on end-users. If

[214] *Id.*

[215] The State Allocation Methodology is not authorized by Section 254 of the Act, and it is not clear that the FCC possesses the ability to perform such a subdelegation of its USF responsibilities. See *USTA v. FCC*, 359 F.3d 554, 565-568 (D.C. App. 2004).

[216] CTA asserts that the NARUC block grant proposal "is unworkable…." CTA Comments, p. 35.

[217] Qwest Comments, p. 3.

overall local rates rose higher than 125% of the national urban average rate, local carriers could petition the Commission for permission to institute an "interexchange termination charge" to recover some or all of the rates in excess of the 125% benchmark.[218]

Although Qwest claims that the Commission has authority under Section 251(b)(5) of the Act to preempt states in order to implement its plan, it recommends that the Commission refer the issue to the Federal-State Joint Board on Separations. In Qwest's vision the Joint Board would recommend that all intercarrier compensation be placed under federal control, thus ending the jurisdictional quandary.[219] Since all intercarrier issues would be under federal control, the Commission could raise the SLC with impunity.

Qwest's proposal contains numerous flaws. First, Qwest's proposal for an uncapped SLC is based on a non-existent uni-jurisdictional world brought about by speculative Joint Board action. Qwest never explains how the actions of a Joint Board on Separations can bind all the states, or undo the restrictions of Section 152(b) of the Act. Second, Qwest's plan would result in continued variation in ICC rates. Although Qwest's plan is based on bill-and-keep, it allows reimposition of carrier-by-carrier termination charges if local rates exceed 125% of the national average urban rate. Given that many local rates are already at or near that benchmark, it is an absolute certainty that termination rates would be established for many, but not all local carriers.[220] Third,

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[218] *Id.*, p. 7.

[219] *Id.*, pp. 15-17.

[220] It is ironic that Qwest states that under the current calling party pays regime, there is "a constant need … to regulate the termination rates that carriers charge each other." Qwest Comments, p. 21. However, Qwest proposes as an integral part of its plan, the continuation of termination charges for carriers with local rates higher than 125% of the national average urban rate.

Qwest's plan includes numerous points that favor only ILECs, such as immediate imposition of bill-and-keep on demonstrably out-of-balance traffic and ISP-bound traffic.[221] Fourth, Qwest provides no estimate of the revenue or rate impact of its plan. Fifth, and most importantly, Qwest's proposal would result in unavoidable increases in local rates for all customers across the United States. While the ICF proposed an unacceptable increase in the SLC cap to $10 per line per month, Qwest proposes to raise the SLC with no cap other than the end result on overall rates.[222]

C. BellSouth's ICC Proposal

Bell South proposed a "unified compensation plan" in its initial comments.[223] BellSouth's plan calls for establishment of uniform points of interconnection and transition in two phases to unified ICC rates of $0.0025 per MOU for all traffic switched through a tandem and $0.00125 per MOU for all traffic exchanged at an end office. During Phase I, all rates would be lowered to interstate access levels in four steps. During Phase II all ICC rates are lowered to the final target rates. [224]

Reductions in carrier revenue resulting from reduction in ICC rates would be replaced by increases in the SLC caps. Larger carriers would have a SLC cap of $12.00 per month, while rural carriers (called Covered Rural Telephone Companies or CRTCs in

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[221] Qwest Comments, p. 8.

[222] Qwest states that its plan includes an increase to the SLC and that this "will increase the number of people eligible for relief under federal lifeline programs." Qwest Comments, p. 18. This is incorrect. An increased SLC will increase the benefits received by current and future lifeline customers, but it will not increase the number of people eligible for lifeline. Eligibility for Lifeline is based on a customer's income or participation in an income-based benefit program.

[223] BellSouth Comments, pp. 16-39.

[224] *Id.*, pp. 27-30.

BellSouth's plan) would be allowed an even higher SLC cap.[225] Unfortunately, BellSouth neglects to mention the ultimate limit of the rural SLC cap. BellSouth proposes that carriers be given maximum flexibility to deaverage SLCs by service category, customer classification and geographic zone, with the presumed result that customers in rural areas would see SLCs far in excess of the $12.00 cap.[226]

In order to accomplish its plan, BellSouth advocates abrogation of all state authority over intercarrier compensation under the rubric of Section 201 of the Act. BellSouth bases its argument on the fact that Section 201 allows the Commission to order interconnection between carriers, and that the 1996 Act imposed an obligation on all carriers to interconnect.[227] However, BellSouth, like the other proponents of preemption, never explains how this interconnection obligation renders Section 152(b) a nullity.

As previously discussed in Section IV.A. above, Congress had the means to abrogate or eliminate state jurisdiction over intrastate traffic if it so chose. However, there is nothing in the 1996 Act that evidences Congressional intent to overturn the strictures of Section 152(b) of the Act which prohibits the Commission from asserting jurisdiction over intrastate matters. In this regard, BellSouth's preemption argument based on Section 201 is no more availing than the preemption arguments of other parties based on Section 251(b)(5).

Like the Qwest proposal discussed above, BellSouth proposes radical restructuring of ICC and local rates, but gives no estimate of the revenue shift under its

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[225] *Id.*, p. 30.

[226] *Id.*, pp. 30-31. Because of the sparse outline of the plan provided in BellSouth's comments, it is unclear whether the overall SLC cap operates as a cap for the deaveraged SLCs as well.

[227] *Id.*, pp. 40-41.

plan, or the impact on carrier revenue or customer rates. Since BellSouth does not incorporate USF funding in its proposal, it must be assumed that all revenue lost as a result of ICC rate reductions will be shifted to local ratepayers by means of SLC increases. It is unclear from the presentation of BellSouth's plan how high a particular customer's SLC can be raised as a result of deaveraging. What is clear is that there is no federal backstop under BellSouth's plan that would help preserve reasonably comparable rates in rural and high-cost areas.

The plans of both BellSouth and Qwest suffer from the same infirmities of other plans that call for federal preemption of state authority and replacement of lost revenue by mandatory rate increases imposed on local customers. The Commission must work within the confines of the existing law to fashion a solution to the disparity in intercarrier compensation while respecting the role of the states in establishing intrastate rates for carriers and customers alike. NASUCA's plan is the only proposal that offers such a solution.

C. The Proposals of CTIA and the Independent Wireless Carriers

Two wireless groups -- CTIA and IWC[228] -- have proposed similar ICC reform plans. CTIA call its plan "Mutually Efficient Traffic Exchange" ("METE"),[229] while IWC applies the moniker "Originating Network Pays."[230] In reality, both proposals are bill-and-keep by different names.[231] While NASUCA supports the efforts of CTIA and

[228] IWC consists of Western Wireless and SunCom Wireless.

[229] CTIA Comments, p. 10.

[230] IWC Comments, Ex. 1, p. 5.

[231] CTIA Comments, p. 10.

IWC to have transport, transit rates and universal service based on forward-looking costs,[232] the movement to mandatory bill-and-keep for originating and terminating charges would create incentives equally as perverse as those existing under the current system. These shortcomings have been discussed extensively above. Finally, NASUCA agrees with CTIA and IWC that regardless of the ICC reform plan adopted, revenue guarantees for incumbents are unnecessary.[233]

X. THE COMMISSION SHOULD ADOPT THE PLAN FOR ICC REFORM PUT FORWARD BY NASUCA.

The proposal submitted by NASUCA is the most evolutionary of the proposals, and the most respectful of state jurisdiction. Except for changes to the USF involved in creating inducements for states to reduce their intrastate access charges and rationalizing local switching support, the NASUCA proposal retains existing structures, continues past progress, and directly addresses the apparent problems in rate disparity that gave rise to this proceeding in the first place. As a result, there is no question concerning the Commission's authority to adopt and implement NASUCA's plan. NASUCA's proposal also maximizes the Commission's flexibility to meet changing conditions since it is an interim plan, and not a purported final solution, as are most of the other proposals. The NASUCA plan does not irrevocably commit the Commission to one course of action or the other. However, adoption of the NASUCA plan would reduce disparities in ICC rates, would result in ICC becoming a proportionately smaller issue, and would set the

[232] *Id.*, p. 6. However, NASUCA has consistently recognized that universal service support based on forward-looking costs may not be appropriate for small rural carriers.

[233] CTIA Comments, pp. 33-34; IWC Comments, Ex. 1, p. 4.

stage for transition to a capacity-based ICC charges if deemed appropriate at the end of the five-year phase-down. The NASUCA plan presents a ready path for the Commission to address the concerns raised in the FNPRM and to continue past progress on access reform. The Commission should act swiftly to adopt and implement the NASUCA proposal.

Respectfully submitted,

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ATTACHMENT A

ARMIS DATA FOR RBOCS

COSA	COMPANY	ROW	TITLE	Y1996	Y1997	Y1998	Y1999	Y2000	Y2001	Y2002	Y2003	Y2004
BNTR	Verizon Bell Atlantic	1090	Total Operating Revenues	$6,455,381	$6,565,135	$6,920,584	$7,263,513	$7,774,310	$8,142,706	$8,107,676	$8,226,806	$8,243,428
BNTR	Verizon Bell Atlantic	1190	Total Operating Expenses	$4,555,252	$4,506,548	$4,882,914	$5,004,627	$5,434,211	$5,681,742	$5,907,403	$6,783,039	$6,458,585
BNTR	Verizon Bell Atlantic	1290	Other Operating Income/Losses	-$4,804	$1,625	-$6,305	$15,260	-$1,229	$11,074	-$1,715	$7,260	$8,865
BNTR	Verizon Bell Atlantic	1390	Total Non-operating Items (Exp)	-$11,579	-$9,625	-$21,111	-$19,301	-$33,975	-$39,271	-$21,278	-$10,823	-$8,409
BNTR	Verizon Bell Atlantic	1490	Total Other Taxes	$393,532	$400,828	$445,611	$478,380	$459,466	$482,772	$498,280	$457,191	$504,539
BNTR	Verizon Bell Atlantic	1590	Federal Income Taxes (Exp)	$433,078	$484,769	$456,101	$530,351	$540,017	$586,608	$495,964	$250,757	$350,240
BNTR	Verizon Bell Atlantic	1910	Average Net Investment	$8,302,389	$8,063,446	$8,476,724	$8,937,223	$9,969,369	$10,927,102	$10,603,502	$9,729,459	$8,580,508
BNTR	Verizon Bell Atlantic	1915	Net Return	$1,080,298	$1,184,246	$1,150,762	$1,284,716	$1,373,361	$1,441,927	$1,225,593	$753,903	$947,338
				13.01189%	14.68660%	13.57555%	14.37489%	13.77581%	13.19588%	11.55838%	7.74866%	11.04058%
BSTR	BellSouth Corporation	1090	Total Operating Revenues	$3,426,741	$3,652,930	$3,906,007	$4,045,767	$4,236,311	$4,660,379	$4,698,525	$4,850,022	$5,041,187
BSTR	BellSouth Corporation	1190	Total Operating Expenses	$2,282,411	$2,362,213	$2,519,032	$2,542,193	$2,450,625	$2,879,324	$3,048,465	$3,121,756	$3,224,567
BSTR	BellSouth Corporation	1290	Other Operating Income/Losses	$1,598	-$117	$304	-$550	$2,190	-$67	$1,052	$16	-$14
BSTR	BellSouth Corporation	1390	Total Non-operating Items (Exp)	-$1,375	-$22	$248	-$2,385	-$4,136	-$3,808	$363	$1,268	$1,800
BSTR	BellSouth Corporation	1490	Total Other Taxes	$169,608	$172,251	$192,593	$196,928	$187,241	$191,995	$193,842	$187,176	$271,556
BSTR	BellSouth Corporation	1590	Federal Income Taxes (Exp)	$277,222	$333,671	$352,763	$402,132	$505,342	$496,692	$464,499	$489,607	$499,638
BSTR	BellSouth Corporation	1910	Average Net Investment	$4,852,789	$4,761,659	$4,694,980	$4,941,823	$5,315,088	$5,920,394	$5,868,709	$5,435,064	$5,140,361
BSTR	BellSouth Corporation	1915	Net Return	$700,478	$784,700	$841,675	$906,349	$1,099,428	$1,096,108	$992,405	$1,050,228	$1,043,608
				14.43454%	16.47955%	17.92713%	18.34038%	20.68504%	18.51411%	16.91011%	19.32319%	20.30223%
GTTC	Verizon GTE	1090	Total Operating Revenues	$2,950,420	$3,126,549	$3,392,344	$3,497,159	$3,543,005	$3,671,712	$3,326,781	$3,511,234	$3,657,148
GTTC	Verizon GTE	1190	Total Operating Expenses	$1,759,931	$1,752,848	$2,024,974	$1,786,274	$1,733,109	$1,812,098	$1,728,811	$1,993,784	$1,996,772
GTTC	Verizon GTE	1290	Other Operating Income/Losses	$725	$2,678	$1,563	$389	$251	$1,767	$3,490	$1,674	$3,634
GTTC	Verizon GTE	1390	Total Non-operating Items (Exp)	-$1,776	-$1,071	$38	$347	-$154	-$2,261	$154	-$1,751	-$1,387
GTTC	Verizon GTE	1490	Total Other Taxes	$148,932	$153,320	$153,119	$170,957	$181,322	$159,531	$159,860	$176,849	$207,008
GTTC	Verizon GTE	1590	Federal Income Taxes (Exp)	$317,859	$379,808	$372,450	$484,858	$521,560	$549,565	$461,867	$428,262	$467,640
GTTC	Verizon GTE	1910	Average Net Investment	$4,287,719	$4,220,332	$4,388,556	$4,512,779	$4,419,009	$4,274,444	$3,995,976	$3,730,792	$3,678,357
GTTC	Verizon GTE	1915	Net Return	$726,198	$844,313	$843,326	$1,055,117	$1,107,423	$1,154,544	$979,569	$915,762	$990,748
			Return %	16.93670%	20.00584%	19.21648%	23.38065%	25.06044%	27.01039%	24.51389%	24.54605%	26.93453%
SBTR	SBC Communications	1090	Total Operating Revenues	$6,978,562	$7,042,184	$7,687,547	$8,254,495	$8,932,712	$9,622,874	$9,197,651	$9,163,828	$9,007,981
SBTR	SBC Communications	1190	Total Operating Expenses	$4,595,348	$4,945,301	$5,225,979	$5,379,601	$5,582,219	$5,580,018	$5,923,204	$6,125,851	$5,991,182
SBTR	SBC Communications	1290	Other Operating Income/Losses	$142	-$1,900	-$1,799	-$164	$19,795	$832	$2,449	$4,393	$4,947
SBTR	SBC Communications	1390	Total Non-operating Items (Exp)	-$7,937	-$11,921	-$4,350	-$6,904	-$15,074	-$20,203	-$9,433	-$4,661	$192
SBTR	SBC Communications	1490	Total Other Taxes	$345,629	$325,169	$379,992	$357,031	$362,977	$375,031	$455,153	$436,365	$414,347
SBTR	SBC Communications	1590	Federal Income Taxes (Exp)	$578,054	$484,463	$611,110	$766,006	$936,012	$1,168,229	$889,040	$837,313	$851,998
SBTR	SBC Communications	1910	Average Net Investment	$9,343,452	$9,631,804	$9,482,894	$9,317,047	$10,257,122	$11,035,096	$10,724,515	$8,960,890	$7,917,409
SBTR	SBC Communications	1915	Net Return	$1,467,610	$1,297,272	$1,473,017	$1,758,596	$2,086,366	$2,520,629	$1,942,132	$1,773,353	$1,755,210
			Return %	15.70736%	13.46863%	15.53341%	18.87504%	20.34066%	22.84193%	18.10928%	19.78992%	22.16899%
USTR	Qwest Corporation	1090	Total Operating Revenues	$2,724,329	$2,776,812	$2,882,307	$3,167,869	$3,419,233	$3,626,710	$3,598,373	$3,679,103	$3,751,101
USTR	Qwest Corporation	1190	Total Operating Expenses	$1,807,174	$1,806,134	$1,893,650	$1,961,136	$2,091,197	$2,185,506	$2,190,312	$2,227,258	$2,181,047
USTR	Qwest Corporation	1290	Other Operating Income/Losses	$0	-$3,518	-$6,059	$2,236	$14	-$38	-$60	$571	$1,256
USTR	Qwest Corporation	1390	Total Non-operating Items (Exp)	-$4,051	-$385	$480	-$5,512	-$12,917	-$12,811	-$6,714	-$3,359	-$2,713
USTR	Qwest Corporation	1490	Total Other Taxes	$128,023	$138,800	$112,606	$127,056	$124,149	$111,410	$125,840	$141,832	$177,171
USTR	Qwest Corporation	1590	Federal Income Taxes (Exp)	$226,272	$245,209	$265,462	$341,508	$374,438	$422,210	$392,023	$397,398	$427,979
USTR	Qwest Corporation	1910	Average Net Investment	$4,061,263	$3,865,936	$3,725,083	$3,842,608	$4,278,813	$4,773,586	$4,445,104	$3,938,016	$3,373,083
USTR	Qwest Corporation	1915	Net Return	$566,911	$583,536	$604,050	$745,917	$842,380	$920,357	$896,852	$916,545	$968,873
			Return %	13.95898%	15.09430%	16.21575%	19.41174%	19.68724%	19.28020%	20.17618%	23.27428%	28.72366%
VCTR	Verizon Communications	1090	Total Operating Revenues	$9,460,733	$9,963,570	$10,601,900	$11,067,077	$11,614,655	$12,120,319	$11,706,436	$11,971,828	$12,136,006
VCTR	Verizon Communications	1190	Total Operating Expenses	$6,333,920	$6,413,990	$7,074,186	$7,007,455	$7,373,869	$7,700,465	$7,815,285	$8,965,285	$8,640,965
VCTR	Verizon Communications	1290	Other Operating Income/Losses	-$4,079	$4,303	-$4,742	$15,649	-$978	$12,841	$1,775	$8,934	$12,499
VCTR	Verizon Communications	1390	Total Non-operating Items (Exp)	-$13,355	-$10,696	-$21,073	-$18,954	-$34,129	-$41,532	-$21,124	-$12,574	-$9,796
VCTR	Verizon Communications	1490	Total Other Taxes	$544,206	$568,144	$612,521	$659,846	$660,357	$665,699	$681,773	$645,574	$721,846
VCTR	Verizon Communications	1590	Federal Income Taxes (Exp)	$762,985	$900,724	$866,655	$1,042,967	$1,061,577	$1,136,173	$957,831	$679,019	$817,880
VCTR	Verizon Communications	1910	Average Net Investment	$12,635,956	$12,741,516	$13,292,141	$13,838,682	$14,741,376	$15,515,202	$14,871,222	$13,694,976	$12,441,743
VCTR	Verizon Communications	1915	Net Return	$1,828,900	$2,095,707	$2,064,866	$2,391,416	$2,552,006	$2,672,351	$2,274,437	$1,703,457	$1,977,609
			Return %	14.47378%	16.44786%	15.53449%	17.28066%	17.31186%	17.22408%	15.29422%	12.43855%	15.89495%

ADJUSTMENT TO NORMALIZE CORPORATE EXPENSE

Unadjusted Return									
Company	**Y1996**	**Y1997**	**Y1998**	**Y1999**	**Y2000**	**Y2001**	**Y2002**	**Y2003**	**Y2004**
BellSouth Corporation	14.43454%	16.47955%	17.92713%	18.34038%	20.68504%	18.51411%	16.91011%	19.32319%	20.30223%
Qwest Corporation	13.95898%	15.09430%	16.21575%	19.41174%	19.68724%	19.28020%	20.17618%	23.27428%	28.72366%
SBC Communications	15.70736%	13.46863%	15.53341%	18.87504%	20.34066%	22.84193%	18.10928%	19.78992%	22.16899%
Verizon Communications	14.47378%	16.44786%	15.53449%	17.28066%	17.31186%	17.22408%	15.29422%	12.43855%	15.89495%
Authorized Return	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%
Adjust Corporate Expense to Y2000 Levels									
BellSouth Corporation	$127,528	$103,432	$40,181	$45,539	$0	$117,266	$119,330	$127,694	$167,818
Qwest Corporation	-$73,202	-$51,526	-$22,720	-$60,863	$0	-$65,856	-$122,765	-$37,075	-$95,203
SBC Communications	$101,691	$190,179	$84,680	$66,605	$0	-$149,108	$175,101	$154,321	$216,779
Verizon Communications	$197,411	$182,267	$283,546	$48,940	$0	$425,949	$636,123	$1,288,555	$837,838
Return Incorporating Adjusted Corporate Expense									
BellSouth Corporation	$819,200	$884,736	$851,968	$950,272	$1,048,576	$1,179,648	$1,048,576	$1,114,112	$1,179,648
Qwest Corporation	$491,520	$524,288	$557,056	$655,360	$819,200	$851,968	$753,664	$851,968	$851,968
SBC Communications	$1,507,328	$1,441,792	$1,507,328	$1,769,472	$2,031,616	$2,359,296	$2,097,152	$1,900,544	$1,966,080
Verizon Communications	$1,966,080	$2,228,224	$2,228,224	$2,359,296	$2,490,368	$3,014,656	$2,883,584	$2,883,584	$2,752,512
Adjusted Return									
Company	**Y1996**	**Y1997**	**Y1998**	**Y1999**	**Y2000**	**Y2001**	**Y2002**	**Y2003**	**Y2004**
BellSouth Corporation	17.06248%	18.65173%	18.78296%	19.26188%	20.68504%	20.49482%	18.94343%	21.67264%	23.56694%
Qwest Corporation	12.15654%	13.76148%	15.60583%	17.82784%	19.68724%	17.90061%	17.41437%	22.33282%	25.90123%
SBC Communications	16.79573%	15.44312%	16.42639%	19.58991%	20.34066%	21.09375%	19.74199%	21.51208%	24.90700%
Verizon Communications	16.03607%	17.87836%	17.66767%	17.63431%	17.31186%	19.96945%	19.57176%	21.84752%	22.62904%
Authorized Return	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%	11.25000%

Interstate returns by holding company, reported and adjusted for normal corporate operations expenses

BellSouth	**Y1996**	**Y1997**	**Y1998**	**Y1999**	**Y2000**	**Y2001**	**Y2002**	**Y2003**	**Y2004**
Reported Return	14.43454%	16.47955%	17.92713%	18.34038%	20.68504%	18.51411%	16.91011%	19.32319%	20.30223%
Adjusted Return	17.06248%	18.65173%	18.78296%	19.26188%	20.68504%	20.49482%	18.94343%	21.67264%	23.56694%

Qwest	**Y1996**	**Y1997**	**Y1998**	**Y1999**	**Y2000**	**Y2001**	**Y2002**	**Y2003**	**Y2004**
Reported Return	13.95898%	15.09430%	16.21575%	19.41174%	19.68724%	19.28020%	20.17618%	23.27428%	28.72366%
Adjusted Return	12.15654%	13.76148%	15.60583%	17.82784%	19.68724%	17.90061%	17.41437%	22.33282%	25.90123%

SBC	**Y1996**	**Y1997**	**Y1998**	**Y1999**	**Y2000**	**Y2001**	**Y2002**	**Y2003**	**Y2004**
Reported Return	15.70736%	13.46863%	15.53341%	18.87504%	20.34066%	22.84193%	18.10928%	19.78992%	22.16899%
Adjusted Return	16.79573%	15.44312%	16.42639%	19.58991%	20.34066%	21.49071%	19.74199%	21.51208%	24.90700%

Verizon	**Y1996**	**Y1997**	**Y1998**	**Y1999**	**Y2000**	**Y2001**	**Y2002**	**Y2003**	**Y2004**
Reported Return	14.47378%	16.44786%	15.53449%	17.28066%	17.31186%	17.22408%	15.29422%	12.43855%	15.89495%
Adjusted Return	16.03607%	17.87836%	17.66767%	17.63431%	17.31186%	19.96945%	19.57176%	21.84752%	22.62904%